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IN THE

Supreme Court of the United States

October Term, 1965

INDIANA BROADCASTING CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in this case on August 17, 1965.

Opinions Below

The case was tried in the Tax Court before Judge DAWSON and his decision was reviewed by the entire court without dissent (R. 21-58);[1] it is reported at 41 T.C. 793 (1964),

1. Portions of the record which were printed for use of the Court of Appeals will be cited herein to pages of the Joint Appendix, as "R. ——"; the exhibits which were not printed will be cited by number, as "Ex. ——." Nine copies of the Joint Appendix have been furnished for the use of this Court in connection with this petition for certiorari, together with nine binders (similar to binders handed up to the Court of Appeals) containing copies of Ex. 19-S, 24, 25, 26 and 27, the exhibits principally referred to herein.

and is printed in Appendix D annexed hereto, pp. 18a-53a, *infra*. The opinion of the Court of Appeals was written by District Judge MERCER; it is reported at 350 F. 2d 580 (7th Cir. 1965), and is printed in Appendix B, pp. 4a-16a, *infra*. Both opinions below will hereafter be cited to pages of the annexed Appendices, as "p. —a, *infra*."

Jurisdiction

The judgment of the Court of Appeals was entered on August 17, 1965 (Appendix C, p. 17a, *infra*). Jurisdiction is conferred on this Court by 28 U. S. C. §1254(1).

Questions Presented

1. Is the cost of an intangible asset, such as a television network affiliation contract, having a fixed initial term with a substantial but statistically measurable probability of renewal for additional terms, subject to depreciation over a period which is equal to the forecast average life, including renewal terms, for such contracts?

2. Did the Court of Appeals apply improper standards for appellate review (a) in setting aside as "clearly erroneous" the Tax Court's ultimate finding that the forecast average life of network affiliation contracts such as those at issue was 20 years, and (b) in ignoring a governing Treasury Regulation relating to "the general experience in the industry" to which the Tax Court had given extensive consideration?

Statute and Regulations Involved

The statute and principal Regulations here involved are Section 167(a) of the Internal Revenue Code of 1954 and Treasury Regulations §§1.167(a)-1 and 1.167(a)-3. Section 167(a) of the Code provides:

> "(a) GENERAL RULE.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
>
> (1) of property used in the trade or business, or
>
> (2) of property held for the production of income."

The pertinent provisions of the Regulations are set out in Appendix A, pp. 1a-3a, *infra*.

Statement of the Case

In November 1956 the taxpayer, a newly-organized corporation, acquired all the assets of television station WISH-TV, Indianapolis, Indiana, and television station WANE-TV, Fort Wayne, Indiana, together with two radio stations in those cities, at a total cost of about $11,000,000 (R. 8-9). Among the assets of each television station was a network affiliation contract with the Columbia Broadcasting System (CBS) (R. 9-10).

A network affiliation contract is an asset of the utmost importance to a television station. It provides the station, without cash outlay, with a dependable supply of network programs which assure the station of a large audience. There is no comparable source of programs available to a

non-affiliated television station, and the loss of its affiliation contract may convert a profitable station into one operating at a loss (R. 95-98, 102-103, 113-118; see p. 40a n.5, *infra* [Tax Court], pp. 10a-11a, *infra* [Court of Appeals]).

During the taxable years in question, CBS was the dominant network in terms of audience appeal. The audience appeal of its programs was somewhat greater than that of programs provided by the National Broadcasting Company (NBC) to its network affiliates, and was substantially greater than that of programs provided by the American Broadcasting Company (ABC) to its affiliates (R. 102; see p. 31a, *infra*). It was this relative strength of the audience appeal of CBS programming, resulting in larger viewing audiences for CBS-affiliated stations and consequently higher advertising revenues and profits, that gave a CBS affiliation contract its great value to a station (R. 116-117; see p. 33a, *infra*).

The Tax Court found, and the Court of Appeals substantially agreed, that the value of the taxpayer's two stations would have been decreased by some $5,000,000 if they had been affiliated with ABC, rather than CBS (and would have been still less with no affiliation contracts). This $5,000,000 difference in value was found to be attributable to the value of the CBS affiliation contracts (see pp. 33a-34a, *infra* [Tax Court], p. 11a, *infra* [Court of Appeals]; Ex. 22; R. 150-151).

All network affiliation contracts are limited to a term of two years by a rule [now 47 C. F. R. §73.658(c)] of the Federal Communications Commission (FCC), but such a con-

tract may contain, as did the contracts acquired by the taxpayer, a clause providing for renewal of the contract for successive two-year terms unless either the station or the network gives notice of non-renewal six months prior to the expiration date of any two-year term (R. 10, 11, 19). At the time of the taxpayer's acquisition in November 1956, the current terms of these affiliation contracts ended, respectively, in August and September of 1958 (R. 10). Pursuant to provisions of the contracts, CBS consented in writing to the transfer of the contracts to the taxpayer (R. 10). Each contract has subsequently been renewed for additional two-year terms (R. 11). Each of these contracts was substantially similar to the form of CBS contract generally in use at the time, and generally comparable to those in use by NBC and ABC (see Stipulation par. 33, R. 19; pp. 29a, 51a, *infra*).

The Tax Court—in a finding which was not contested on appeal—established that of the total cost of acquisition, some $4,473,000 represented the cost to the taxpayer of physical assets, approximately $2,000,000 the cost of goodwill and other nondepreciable intangibles, and $4,625,000 the cost of the two CBS network contracts (see pp. 22a, 34a, 38a, *infra*).

The only contested issues on appeal related to the treatment for Federal income tax purposes of the $4,625,000 cost of the two network affiliation contracts. The major portion of the three-day trial before the Tax Court was devoted to evidence relating to determination of the estimated useful life of these contracts for depreciation purposes, including testimony and exhibits on the issues as to whether an estimated useful life for such contracts could be estab-

lished with the degree of accuracy required for depreciation purposes by reference to prior experience; the relevance to the taxpayer's contracts of general industry experience as to the life of such contracts; the construction and use of a life expectancy table applicable to such contracts to determine their estimated useful life including renewal terms; and the reasonableness of the resulting depreciation allowances in the taxable years 1957, 1958 and 1959, which are involved in this case.

There was first introduced into evidence, by stipulation of the parties, a complete history of the duration of network affiliation contracts from the beginning of the television industry to substantially the date of trial in each of the 84 market areas in the United States which, like Indianapolis and Fort Wayne, had three or more commercial television stations (Ex. 19-S).[2] This compilation, in tabular and chart form, was the product of joint efforts by the taxpayer and the Commissioner, working over a period of months with data from various industry sources. The information thus developed was integrated, and the results were verified at the Commissioner's request by the CBS and NBC television networks (see Ex. 19-S, pp. i-ii; p. 46a, *infra*).

Expert testimony relating to that history and otherwise directed to the issues contested at trial was received in evidence. Insofar as such testimony relates to the issues contested on appeal, it is summarized below.

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2. Nine copies of Ex. 19-S, and of Ex. 24 through 27, referred to hereafter, have been furnished for use of the Court.

Charles H. Tower,[3] in addition to giving testimony on background matters not contested on appeal, testified that he had reviewed the detailed history of the duration of network affiliation contracts to which the parties had stipulated in Exhibit 19-S. Upon the basis of his knowledge of the industry, he selected those segments of industry experience reflected in that history which he considered reasonably comparable to the taxpayer's stations for use in developing a life expectancy table applicable to the taxpayer's contracts in the three taxable years at issue (R. 122-136).

Mr. Tower testified that he thought two segments of industry experience should be taken into account (R. 127-136; see pp. 47a-48a, *infra*):

> (1) The broad experience with respect to all of the CBS and NBC affiliation contracts from the beginning of the industry to the end of the period being examined ("aggregate experience"); and
>
> (2) A more refined experience relating only to CBS contracts and restricted in time to the period after there were sufficient stations in the particular market to give CBS the opportunity to choose between its existing affiliate and at least one other station in the com-

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3. Mr. Tower has been an executive officer of the taxpayer's parent company since 1961, concerned with the management of the five television stations controlled by it. From 1949 to 1961 he was an officer of the National Association of Broadcasters, in which capacity he was engaged, among other matters, in making studies of revenues, operating costs and various management problems of television and radio stations, and was in regular contact with station managements throughout the nation (R. 91-95).

munity not affiliated with NBC ("selected CBS experience").[4]

Mr. Tower explained that he did not consider the "selected CBS experience" alone to be satisfactory for the purpose of developing a life expectancy table applicable to the taxpayer's contracts because it did not take into account, to the extent the "aggregate experience" did, the period of instability which had existed in the years 1953-55, immediately following the end of the four-year FCC "freeze" on construction of new stations (R. 136; see also R. 120, 124; see p. 47a, *infra*). Mr. Tower stated that in his judgment instability similar to that characterizing this earlier period of instability would return to the industry in the future, and his testimony discussed the effect of various factors that entered into this judgment: Developments in Congressional and FCC policy to encourage the use of UHF channels to bring on the air a greater number of stations; the serious consideration given by the FCC to moving all commercial television to the UHF band for the same purpose; the advent of economic changes, such as pay television; and the

4. The experience with respect to terminations of ABC affiliation contracts, which had a higher incidence of terminations, was excluded from the "aggregate experience" because ABC contracts were not comparable with those of CBS and NBC in value or in circumstances (R. 128-130, 143-145; see pp. 47a-48a, *infra*). Certain situations involving stations owned and operated by the networks also were eliminated from both segments of experience since such stations were not subject to the risk of termination (*ibid.*). In the case of the "selected CBS experience," the experience prior to the end of a minimum 12-month stabilizing period was also eliminated from consideration in order to prevent the data there considered from being affected by terminations directly occasioned by the third station in the market area coming on the air (R. 129-130; see p. 48a, *infra*).

effect of technological advances, such as Telstar[5] (R. 122-127; see p. 48a, *infra*).

Dr. **W. Edwards Deming**[6] testified that he and Dr. Gerald J. Glasser[7] had studied the information contained in the stipulated history relating to duration and termination of affiliation contracts (Ex. 19-S)—with special reference to the two segments thereof, the "aggregate experience" and "selected CBS experience," which had previously been selected by the witness Tower—to determine whether it would be possible from the data contained therein to construct a life expectancy table for affiliation contracts (R.

5. At the time of trial Telstar had not yet been utilized for regular television program transmissions. Since then, the use of satellites such as Telstar for network program transmission in competition with conventional transmission facilities has been proposed. See *New York Times,* May 14, 1965, p. 1. The potential effect on network affiliation of the use of such satellite transmission by program sources other than the networks was noted in the news story, as follows:

> "If domestic television satellites ultimately come into existence, according to some industry officials last night, they might ultimately have a bearing on the number of networks in operation.
>
> "An electronic bird capable of carrying more than three channels, it was noted, might prove to be a feasible way of linking independent stations or educational outlets that are now largely served by films or tape recordings shipped by mail or air express."

6. Dr. Deming is a consultant-statistician and professor of statistics in New York University. Over the years, he has acted as statistical consultant to various agencies of the Government, including the Department of Agriculture, Bureau of the Census and Bureau of Internal Revenue. He has also been a consultant to foreign governments, including India, Japan, Mexico and Germany (R. 153-157).

7. Dr. Glasser, who assisted Dr. Deming in the preparation of a written statistical analysis of affiliation contract terminations which was received in evidence (Ex. 24), is also a statistician of wide experience (see Ex. 25).

159); and had concluded that the data reflected in such segments of experience were consistent with a statistical method known as the Poisson-exponential theory of failure (R. 159-162, 167-168). This method is widely used in the business and scientific world, Dr. Deming stated, for forecasting average life, pricing, setting warranties, maintenance and other purposes (R. 161-162, 167-168; see Ex. 24, pp. 3-4).

Dr. Deming explained that the characteristic of items to which the Poisson theory applies is that in the group of such items existing at any time the proportion of failures (in the present context, terminations of affiliation contracts) in a given time interval will be a constant; that is, if the annual rate of failure is 5%, at the end of the first year 5% will have failed, in the second year 5% of the surviving 95% will fail, in the third year 5% of the remaining group will fail, and so on (R. 160-161). Dr. Deming gave examples of tangible assets having a life expectancy with this characteristic (glass tumblers in a restaurant, vacuum tubes and loading coils) (R. 161).

This statistical method was employed in constructing a life expectancy table for affiliation contracts, which is set forth in the written statistical analysis of affiliation contract terminations which Dr. Deming and Dr. Glasser had prepared (see Ex. 24, p. 9), and which Dr. Deming explained in his testimony (R. 160-162).[8] In this table the median life of network affiliation contracts is shown to be just under 14 years, and the mean life (or arithmetic average) is 20 years. Dr. Deming explained that the table also showed

8. The manner in which this table was developed is fully described in the Tax Court's opinion (see pp. 48a-49a, *infra*).

there were about two chances out of three that an affiliation contract would terminate by the end of its twentieth year (R. 166-167; see also R. 180-181 [Dr. Jones]; see pp. 37a, 49a, *infra*).

Dr. **Ralph C. Jones,**[9] in testimony consisting of a step-by-step analysis accompanied by explanatory charts (Ex. 26 and 27), based on the statistical evidence, examined various methods of accounting for the cost of network affiliation contracts, and demonstrated the reasonableness of depreciation allowances based on the industry experience (R. 178-198; see Appendix E, pp. 54a-62a, *infra*).

Dr. Jones explained that in order to reflect income fairly the cost of an affiliation contract must be spread over the period of its useful life. He then testified that a "benchmark" for testing any proposed method of accounting for such cost would be to compare its result on the revenue flow to the Treasury with the result that would occur if each taxpayer had foreknowledge of the actual duration of its individual contract and took depreciation deductions over the period of such foreseen duration. Of course, since foreknowledge of the future does not exist in life, each taxpayer, as Dr. Jones noted, would in fact have to use "some kind of an average rate" to compute depreciation (R. 186; see p. 49a, *infra*).

His testimony showed that if depreciation were taken for individual contracts over either the median life of 14

9. Dr. Jones is Professor of Economics at Yale University, where for almost 40 years he has been in charge of all courses in accounting. He has made various scholarly studies of economic matters relating to accounting and taxation (R. 177-178).

years or the mean life of 20 years shown by the life-expectancy table, the result would be fair both to taxpayers and to the national Treasury in that the resulting aggregate of deductions for depreciation, and deductions reflecting the losses occurring upon terminations prior to completion of depreciation, would approximate the aggregate deductions that would be allowable to taxpayers according to the "benchmark" based on foreknowledge (see especially R. 179-180, 188-190, 194-195).

Dr. **Hyman H. Goldin,**[10] the Commissioner's principal witness, in addition to testimony on background facts, took issue with Mr. Tower regarding various factors in the television industry as they related to developing a life expectancy table appropriate to the taxpayer's affiliation contracts (R. 214-223, 231-249, 257-262, 265-266). For example, Dr. Goldin disagreed with Mr. Tower's judgment that periods of instability similar to the one which had followed the end of the "freeze" would recur in the industry (R. 209-211, 215). On cross-examination of Dr. Goldin, the taxpayer introduced into evidence, over the Commissioner's objection, a 1958 CBS policy statement setting forth various criteria governing choice of affiliates by CBS, and the taxpayer cross-examined Dr. Goldin about the effect of some

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10. Dr. Goldin is Assistant Chief for Policy and Planning of the Broadcast Bureau of the Federal Communications Commission. The holder of a doctor's degree in Public Administration from Harvard University, he has been a member of the staff of the Commission since 1943. He was a member of its Network Study Staff, particularly concerned with affiliation practices, and has testified frequently before Congressional committees (R. 205-209).

of the criteria discussed in the CBS statement (Ex. 28, R. 61-67, 253-254; R. 236-239, 243-244).[11]

After reviewing the testimony and supporting exhibits in its findings of fact, the Tax Court found that the median life of network affiliation contracts comparable to taxpayer's was just under 14 years, that their mean (arithmetic average) life was 20 years, and that there were about two chances out of three that any such contract would terminate before completing its twentieth year (see pp. 37a, 49a, *infra*). The court then made "Ultimate Findings" that an estimated useful life of the taxpayer's network affiliation contracts for depreciation purposes could be determined with reasonable accuracy from the statistical data and analyses before it, and that use of the straight-line method over a 20-year period produced a reasonable allowance for depreciation (see pp. 38a, 53a, *infra*). Judge Dawson's decision was reviewed by the entire Tax Court without dissent.

On appeal, the Seventh Circuit, reversing in an opinion by District Judge Mercer, ruled that a television network affiliation contract is a nondepreciable asset (see pp. 4a-5a, 16a, *infra*). In dealing with the Tax Court's Ultimate Findings, the Court of Appeals, invoking the "clearly erroneous" formula, re-appraised various factual elements relating to the industry which it thought the trial court had either "overlooked" or misapplied; the Court of Appeals

11. The Commissioner also called Mr. Sarkes Tarzian, the owner of a company operating stations competing with the taxpayer's stations. His testimony was limited to a description of occurrences of affiliation changes in the Indianapolis television market area and his opinions relating to the ABC affiliations of the stations operated by his company in Fort Wayne and another city (R. 267-290).

did not mention the governing Treasury Regulation directing that depreciable life be determined by reference to "the general experience in the industry."

Reasons for Granting the Writ

I. This case involves an important question of Federal tax law which has not been, but should be, settled by this Court.

The question presented by this case is the amount of annual depreciation, if any, properly allowable for the cost of a business contract having a fixed initial term and a substantial but statistically measurable probability of renewal for additional terms of equal length.

The Timeliness of the Question

Neither the statute nor the Treasury Regulations deal specifically with this question. This Court has never passed on the principles governing depreciation of intangible assets. There is pending before the Court in the current Term a series of cases on depreciation issues,[12] but these do not bear significantly on the depreciation of intangibles. The many cases decided by lower courts dealing with intangibles do not give adequate guidance in this situation. That is shown by the outright rejection here by the appel-

12. *Fribourg Navigation Company, Inc.* v. *Commissioner,* No. 23, pending after oral argument; *Motorlease Corp.* v. *United States,* No. 24, and *United States* v. *S & A Co.,* No. 50, pending on petitions for certiorari (all involving depreciation of tangible assets in the year of sale). *But cf. Richmond Television Corp.* v. *United States,* No. 420, cert. granted, vacated and remanded November 8, 1965 (amortization of expenses incurred prior to grant of FCC television license; remanded for consideration of amortization in taxable years commencing with grant of license).

late court of the Tax Court's analysis, which apparently reflected the views of all the judges of that specialized court as to the application of 35 years of judicial precedents.

A great many tax returns involving the question here presented with respect to network affiliation contracts—each of which has a two-year term fixed by FCC rule—are now in litigation or in the process of audit by the Internal Revenue Service.[13] The matter has been in controversy for eight years, the Commissioner having maintained, since the issuance of Revenue Ruling 57-377, 1957-2 C. B. 146, that no depreciation at all is allowable with respect to the cost of acquiring an affiliation contract.

Moreover, the question here presented is pertinent with respect to many other types of business contracts,[14] and the

13. There are now five cases pending in the Tax Court, and another three in the Court of Claims, none of which has yet been tried (in part because counsel there have been awaiting the final outcome of the present case). Proceedings involving at least 15 other television stations are pending at various levels in the Service, and additional proceedings are anticipated as periods of limitations come to run out with respect to other taxpayers affected by this issue in presently open years.

Beyond these pending or immediately prospective cases, however, the matter is of obvious importance with respect to each of the numerous network-affiliated stations that has been sold in recent years, as well as with respect to stations that may be sold in the future. As the Court of Appeals observed herein, the value of a CBS affiliation contract, at least, may be equivalent to the value of all other assets of a station combined (see p. 11a, *infra*). These values are reflected in the allocation of the purchase price for a station among the assets acquired in arriving at the cost to the taxpayer of the respective assets for depreciation and other purposes.

14. Subsequent to its decision in the instant case, the Tax Court has been called upon to determine the proper depreciation allowance, if any, in cases involving varied types of business contracts wherein the deduction has been challenged on the ground that the useful lives

problems raised are sufficiently difficult and important to warrant consideration by this Court.

The Scope of the Question

It is undisputed that the cost of a business contract for a stated term is depreciable over that term where the facts show that the probability of renewal is insubstantial. The question here presented is what the rule should be where the probability of renewal, though substantial, can be statistically measured by reference to experience. In answer to that question, the Tax Court in the instant case ruled that depreciation of the taxpayer's network affiliation contracts should be allowed over a 20-year period, on the basis of statistical analysis of industry experience showing that 20 years represented the forecast average life of contracts found to be similar to those at bar.

The correctness—as a matter of law—of a holding that the cost of acquiring this kind of a contract is depreciable can be tested against the following assumptions:

First, assume—without necessarily deciding—that the probability of renewal of a contract must be at

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of the contracts were indeterminable because of the probability of renewal. See, *e.g., Seaboard Finance Co.,* 1964 P-H T. C. Mem. Dec. par. 64,253 (1964) (personal loan contracts); *Daniel J. Klein,* 1965 P-H T. C. Mem. Dec. par. 65,207 (1965) (customer service contracts). See also *George W. Knipe,* 1965 P-H T. C. Mem. Dec. par. 65,131 (1965) (amortization of cost of FCC broadcast license).

The useful life of a contract may also bear on the proper depreciation allowance for tangible property used in performance of the contract. See, *e.g., Gordon Lubricating Co.,* 1965 P-H T. C. Mem. Dec. par. 65,132 (1965) (amortization of terminal facilities over term of renewable service contract).

least 50% to be deemed sufficiently substantial to bar allowance of depreciation over its stated term;[15] and

Second, assume a contract as to which it has been found that the chances of renewal at the end of its first term are two out of three (a 66⅔% probability) and that there exists an identical probability of renewal at the end of each succeeding term.

Upon these assumptions, the question is whether the cost of acquisition of such a contract should be ruled wholly non-depreciable because of the greater than 50% probability of at least one renewal, or whether, on the other hand, one of the following alternatives should apply:

(i) The contract should be viewed as equivalent to one having a single term of twice the original length, and therefore having only a 44% (66⅔% of 66⅔%) renewal probability, with the result that depreciation would be allowed over the initial term plus one renewal term; or

(ii) Depreciation should be allowed over the somewhat longer period representing the average life of contracts having such assumed 66⅔% renewal probabilities, which period, mathematically calculated, would be three times the original contract term.[16]

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15. *Cf.* R. 179-181 [Dr. Jones]. Compare the provisions, relating to lease renewals, of Code Section 178 and the Regulations thereunder, and of Treas. Regs. §1.162-11(b)(2), which refer to "reasonable certainty" of renewal, except in specific circumstances as to which Section 178 refers to it being "more probable that the lease will not be renewed * * * than that the lease will be so renewed * * *."

16. The mathematical formula for calculation of average life on the facts assumed is the same as the one utilized by the statisticians in the present case in calculating the average life of the affiliation contracts represented on the life expectancy table in their report. See Ex. 24, pp. 8, 10; R. 166-167.

In the case at bar, the Commissioner asserted his position that no depreciation at all is allowable. The taxpayer contended for the adoption of the approach described in (i) above, which would have resulted in depreciation over 14 years. The Tax Court, in allowing depreciation over 20 years, took the approach described in (ii).[17]

We submit that the rule thus adopted by the Tax Court is both reasonable and sound. As demonstrated by a scholarly and comprehensive analysis put in evidence by the testimony of Dr. Ralph C. Jones, and graphically illustrated by a series of charts he had prepared, the rule would produce a result, as between taxpayers on the one hand and the national Treasury on the other, of aggregate depreciation deductions in amounts and at times fair and proper to both.[18]

The Court of Appeals rejected the legal rule laid down by the Tax Court with respect to intangibles such as network affiliation contracts, on reasoning which is in part

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17. In the case at bar, although the contracts are for a two-year term, statistical analysis was made, for convenience of reference, on the basis of an annual rate of termination. Such annual rate was .050 (5%), resulting in a median life of 14 years and a mean (average) life of 20 years (Ex. 24, pp. 6, 8; R. 165-167).

18. Dr. Jones, a Professor of Economics at Yale University, has had broad experience in economics relating to accounting and tax matters (R. 177-178). A full description of his analysis, including a composite of the pertinent charts, is set out in Appendix E, pp. 54a-62a, *infra*. Nine copies of the original charts (Ex. 26, 27) have been furnished for the use of the Court.

It should also be noted that since the enactment of Code Section 1245 in 1962, the national Treasury is fully protected against any loss in revenue resulting from conversion of ordinary income into capital gain, since depreciation allowed in individual cases which is ultimately found to have been excessive is subject to recapture in full at ordinary income rates.

explicit and in part implied in its opinion. A comparison of the opinion of the Court of Appeals with that of the Tax Court on this point shows that the legal question here presented turns on whether the existence of one or more of the following undisputed facts bars depreciation under the governing statute and Regulations:

> (a) Affiliation contracts do not have a "normal" life span, in the sense that the bulk of the contracts do not terminate at approximately the same age but rather display a great range in their individual life spans;
>
> (b) Individual contracts do not decline in value prior to termination merely because of use or the passage of time; and
>
> (c) The length of the average life forecasted for affiliation contracts was longer than the period of industry experience observed.

It is the taxpayer's position, and the Tax Court held, that these factors—while distinguishing affiliation contracts from most (but not all) tangible assets—do not bar depreciation so long as it is possible to construct a reasonably reliable life expectancy table applicable to such contracts, from which table an average life can be forecast.

The Basic Nature of the Question

This Court will recognize that allowing no depreciation at all in cases such as that at hand necessarily would result in overstatement of net income during the taxable periods benefited by the contract, thus defeating the statutory design of the allowance for depreciation, which, as the Court pointed out in *Massey Motors, Inc.* v. *United States,* 364 U. S. 92, 96 (1960), is to make a "meaningful

allocation" of the "cost" of an asset "to the tax periods benefited by the use of the asset."

The Commissioner accepts this principle with respect to tangible assets, of course.[19] The questions presented by the instant petition basically amount to whether this long-understood principle of depreciation is to be recognized, despite the Commissioner's resistance, as applicable to intangible assets such as the contracts here at issue. In addition to the purely legal aspect just discussed, this fundamental point goes to the heart of the interpretation of the Regulation regarding "the general experience in the industry" (as is discussed under Point II(B) at pp. 33-35, *infra*). The questions thus presented are basic to the income tax law affecting intangibles, and should be resolved by this Court.

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19. See the introductory statement as to the basic purpose and principles of depreciation in the Commissioner's brief in *Fribourg Navigation Company, Inc.* v. *Commissioner,* O. T. 1965, No. 23, at pp. 11-15. There the Commissioner states (p. 12):

> "Fairness, however, requires that the taxpayer be entitled to periodic deductions in the tax periods when the machine or ship is contributing to income.[4] Thus certain estimates are employed."

And the Commissioner goes on in the footnote (*id.,* n.4):

> "The alternative, of course, would be to deny the taxpayer any depreciation deductions until he sold the asset, at which time he would know exactly how much its use had cost him. Then he could either deduct the entire net cost in the year of sale or deduct a portion of the actual net cost in each of the years of actual use. The former solution would result in a bunching of deductions attributible to a number of years. The latter would require taxpayers to amend perhaps a dozen years' returns every time they sell an asset and is (even aside from the problem of the statute of limitations) too wasteful and complicated a solution. See, *e.g., Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359, 365; *Security Mills* v. *Commissioner,* 321 U. S. 281; *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523, 526 ('Congress has elected to make the year the unit of taxation')."

II. The Court of Appeals in this case so far departed from the accepted and usual course of appellate proceedings in the Federal courts as to call for review by this Court.

On the basis of a record consisting largely of testimony of experts for both sides heard in a three-day trial, as well as voluminous and highly technical exhibits, the trial judge who heard the witnesses, including their explanations of the exhibits, made extensive and balanced findings of fact as to specific matters in controversy and reached conclusions as to depreciability of affiliation contracts based on the governing Regulation directing reference to "the general experience in the industry." His decision was reviewed by the entire Tax Court without dissent.

It is not a proper function of an appellate court, as this Court has held,[20] either to criticize a trial judge for the degree of weight given or not given to particular items of evidence or to set aside his carefully formulated findings as to ultimate issues simply because of the appellate court's own preference as to methods to be employed in appraising witnesses and weighing the evidence as a whole. Such action of the Court of Appeals—on this record which fully supports the specific and ultimate findings of the trial court—departed from the accepted and usual course of appellate proceedings in the Federal courts.[21]

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20. *E.g., Commissioner* v. *Duberstein,* 363 U. S. 278 (1960); *United States* v. *United States Gypsum Co.,* 333 U. S. 369 (1948).

21. Examples of Federal tax cases in which the reviewing Court of Appeals has correctly respected factual findings of the Tax Court with which the Court of Appeals did not necessarily agree are: *Hamm* v. *Commissioner,* 325 F. 2d 934 (8th Cir. 1963); *Smith* v. *Commissioner,* 305 F. 2d 778 (3d Cir. 1962); *Rollins* v. *Commissioner,* 276 F. 2d 368 (4th Cir. 1960); *Koepke* v. *Commissioner,* 230 F. 2d 950 (6th Cir. 1956); *Commissioner* v. *Penn Athletic Club,* 176 F. 2d 939 (3d Cir. 1949).

The Court of Appeals, in setting aside the Tax Court's basic findings as "clearly erroneous," made three specific criticisms of the Tax Court's appraisal of the evidence. Thus, the Court of Appeals:

(1) Thought that the Tax Court had "overlooked" the "state of flux which has affected this young industry" (p. 12a, *infra*);

(2) Felt that the Tax Court had not been justified in accepting the expert testimony of Dr. Deming that the data on industry experience of terminations he and Dr. Glasser had examined were consistent with the Poisson-exponential theory (p. 13a, *infra*); and

(3) Thought that the Tax Court had "largely overlooked" the effect of the CBS policy regarding renewal of affiliation contracts (pp. 13a-14a, *infra*).

These criticisms amount to no more than an unwarranted attempt by the appellate court to substitute its own preferences as to methods of evaluating testimony for the judgment of the trial court (see Point II(A), *infra*).

An even more fundamental departure from accepted and usual appellate procedures is presented by the Court of Appeals' total disregard of the Tax Court's extensive consideration of the applicability of Treasury Regulations §1.167(a)-1(b), which directs the use of "the general experience in the industry" in appropriate circumstances (see Point II(B), *infra*). In this connection, the trial judge had subjected the evidence to detailed analysis in order to determine the applicability to the taxpayer's contracts of the general industry experience with network affiliation con-

tracts and to establish the extent to which the cited Regulation bore on the controversy before him. As already indicated, the trial judge's treatment of the matter evoked no dissent when referred to the entire Tax Court for review.

The Court of Appeals—without even mentioning the pertinent Regulation—simply referred to its various factual criticisms of the trial judge's findings (discussed under Point II(A), *infra*) and concluded that "each contract is more unique than generic, which makes it *questionable whether any meaningful general experience could ever be shown*" (p. 9a, *infra*; emphasis added). A peculiar vice of this cavalier treatment of the Tax Court's judicial processes is that it leaves that court—which will continue to be confronted with cases involving the same and similar issues[22]—with no guidelines to help it decide whether to adhere to its own unanimous judgment or to follow the views of a single Circuit Court as to the application of this Regulation.

A. The Court of Appeals was unjustified in holding that the Tax Court had "overlooked" or misapplied specific evidentiary matters.

(1) The Tax Court gave measured consideration to the "state of flux" which has affected the television industry.

The Court of Appeals charged the trial judge with having "overlooked" the "state of flux" which has affected the television industry and its history of affiliation terminations (p. 12a, *infra*). The appellate court concluded that "the stipulated exhibit [Ex. 19-S] strongly suggests that the period of flux yet continues in the industry, and that

22. See p. 15 n.13 and n.14, *supra*.

it colors the industry history to such an extent that there is grave doubt that any reliable norm of contract expectation could be found at this time'' (*ibid.*).

In point of fact, the state of ''flux'' or instability in the industry at one period, the extent to which it had been followed by a period of relative stability, and the probability of new states of ''flux'' in the future, were all thoroughly discussed in testimony of witnesses for both sides at the trial, and these factors were carefully weighed by the Tax Court in its findings and opinion.

The taxpayer's expert witness Tower referred to the period of instability in affiliation relationships which had occurred in the years 1953-55, immediately following the end of the four-year FCC ''freeze'' on new stations, and the period of relatively fewer terminations that had existed from about 1956 to the date of trial. He testified that in selecting segments of the industry experience to be taken into account in developing a life expectancy table applicable to the taxpayer's contracts, experience including that of the earlier period of instability should be taken into account because, in his judgment, similar instability would return to the industry in the future as a result of various technological, economic and regulatory factors which he explained (R. 120, 122-127, 136).

On the other hand, the Commissioner's principal expert witness, Dr. Goldin, expressed the view [contrary to the one apparently adopted by the Court of Appeals (see p. 12a, *infra*)] that the conditions of instability which had existed following the ''freeze'' were things of the past, and that no similar period of instability was to be anticipated in the future (R. 209-211, 215).

The Tax Court took note in its findings of fact and opinion of the varying periods in the industry history, and of the factors of future instability cited by Mr. Tower (see pp. 24a-26a, 48a, *infra*). In his opinion, the trial judge noted (p. 47a, *infra*) that—as Tower had testified—"over the years of commercial television history there have been 'ebbs and flows in the incidence of termination of network contracts.' "[23]

It is thus clear that the Court of Appeals took unwarranted action on review of this record in asserting that the Tax Court had "overlooked" the effects of the "state of flux" in the television industry.

(2) The Tax Court was justified in accepting the expert opinion of Drs. Deming and Glasser that the Poisson-exponential theory is applicable to network affiliation contracts.

As the Court of Appeals properly observed, it is a basic premise of the Poisson-exponential theory that "the life expectancy of all contracts is the same regardless of the length of duration of the contract" (p. 13a, *infra*). Indeed, Dr. Deming specifically testified that the life expectancy characteristic of items consistent with the Poisson theory is that the future life expectancy of each item does not diminish as the item grows older (R. 160-161), and the Tax Court made a finding to this effect (see p. 35a, *infra*).

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23. The context of the trial court's quotation of Mr. Tower's testimony (R. 120) was as follows (p. 47a, *infra*):

> "The 'aggregate experience' included the period of the FCC 'freeze' on new stations, in which there were relatively few terminations, and a subsequent period (1953-1955) in which there were relatively more terminations as an increased number of new stations came on the air. As Tower explained, over the years of commercial television history there have been 'ebbs and flows in the incidence of termination of network contracts.' "

The question of whether the statistical data as to contract terminations in the record exhibited this necessary characteristic was the subject of searching inquiry at the trial and of a definite finding by the trial court.

Dr. Deming, on direct examination, testified that both the "aggregate experience" and the "selected CBS experience" which he had been asked to study were consistent with the Poisson-exponential theory of failure (R. 159-160). Such consistency was also confirmed in the detailed report Drs. Deming and Glasser submitted to the trial court (Ex. 24). Thus, Drs. Deming and Glasser reported to the court (*id.*, p. 3):

> "Our examination of data relating to both the aggregate experience and the selected CBS experience showed that termination of affiliation agreements has characteristics that are consistent with the application of a certain statistical method, called the Poisson-exponential theory of failure * * *."

On redirect examination—having been cross-examined as to whether any of the evidence indicated that "the longer a station remains affiliated with a network * * * the longer it is likely to continue in the future" (R. 170)—Dr. Deming testified that he had examined the data with particular respect to such a possibility, and could find no evidence of any such tendency. Thus, Dr. Deming testified (R. 176):

> "Q. Dr. Deming, in examining the data in the exhibit did you find any support for the theory or the view that life expectancy of an agreement would be longer as it survived a greater period?

"A. I could find no such evidence. I might say that these things, in the question that Mr. Becker [counsel for the Commissioner] asked of me were of very serious concern. They are much more important to me than they are to you.

"I could see no evidence in such a thing. I could draw no such conclusions, sir."

The Commissioner neither further cross-examined Dr. Deming as to this conclusion nor offered any statistical evidence in contradiction. Instead, he relied on inferences sought to be drawn from the testimony of Dr. Goldin and Mr. Tarzian. The testimony of Dr. Goldin—who conceded he had made no statistical study (R. 245, 264-265)—boils down to a listing of possible reasons why a tendency toward progressive longevity might exist (R. 222-223). Mr. Tarzian testified that—insofar as the ABC affiliation of the station in Fort Wayne owned by him was concerned—he believed that this tendency existed (R. 280, 283, 288).

Upon this state of the record, the trial court refused to make a finding, requested by the Commissioner, that "the longer a network remains with a station the longer it will stay with it in the future."[24] On the contrary, the court specifically found that the termination data before it were

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24. At page 21 of the Commissioner's brief in the trial court, the following request for a finding of fact—which was refused by the court—is set forth:

"73. Generally speaking, the longer a network remains with a station the longer it will stay with it in the future (Tr. 212, 292, 299)."

The transcript reference Tr. 212 (R. 222-223) was to the testimony of Dr. Goldin, while Tr. 292 and 299 (R. 283, 288) referred to the testimony of Mr. Tarzian.

"consistent with the Poisson-exponential theory of failure" (p. 35a, *infra*).

Notwithstanding the virtually uncontradicted evidence and the finding cited above, the Court of Appeals concluded that "Whatever its worth in other areas, the Poisson-Exponential theory has no application in this case" (p. 13a, *infra*). In reaching this conclusion, which has no affirmative support in the evidence, the court obviously was influenced by its prior conclusion—made after citing the few examples of contracts which had been terminated after they were in force for nine years—that "the premise that a contract in its ninth year, for example, is no more immune from termination than is a contract in its first year" is not an arguable interpretation of the industry history (*ibid.*).

However, the number of nine-year-old contracts which terminated in any given period—like the number of younger contracts terminating in the same period—was observable to Drs. Deming and Glasser when they made their statistical determinations from the stipulated affiliation history (Ex. 19-S). It was by comparing such number of terminations with the number of annual opportunities for termination (that is, the number of contracts in force at the beginning of each year) that they arrived at annual rates of termination (see p. 36a, *infra*). But the Court of Appeals makes no reference to the obvious necessity of comparing the number of terminations with the number of annual opportunities for termination to draw any valid comparison.[25]

25. The circumstance that there were few terminations of contracts more than nine years old—which so impressed the Court of Appeals—is by itself meaningless. Since the industry began, for all practical purposes, in 1948, there were no nine-year-old contracts

It would thus appear that in overthrowing the Tax Court's factual finding that the rate of termination of the affiliation contracts did not significantly vary with advancing age—a finding which is central to the question of law discussed in Point I, *supra*—the Court of Appeals wholly misunderstood the analysis made by the experienced statisticians whose testimony and written report had been accepted as valid by the trial judge.

(3) The Tax Court did not "largely overlook" the CBS policy governing renewals, but gave due weight to the evidence concerning that policy.

The Court of Appeals makes much of its belief that the trial court "largely overlooked" a CBS policy statement setting forth various criteria governing choice of affiliates (see pp. 13a-15a, *infra*). However, the following circumstances show this belief to be quite mistaken: (a) The CBS policy statement, which was introduced in evidence by the taxpayer over the Commissioner's objection, was extensively used in cross-examining Dr. Goldin about the effect of some of the criteria discussed in the statement (Ex. 28, R. 61-67, 253-254; R. 236-239, 243-244); (b) there was considerable other testimony concerning the policy factors

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before 1957 and no substantial number attained that age until 1958. In order to verify the Tax Court's conclusion that such older contracts had no higher incidence of termination than comparable contracts of all ages in the part of the period under study in which a substantial number of contracts over nine years of age existed, it is necessary to compare the termination rate of such older contracts with the general rate during the same period. Such a calculation has been made under the supervision of Dr. Glasser. It shows that in the period after 1958, when the rate for contracts of all ages in the "selected CBS experience" was .030 (3.0%), the termination rate for all CBS contracts after attaining nine years of age was .029 (2.9%), or almost exactly the same rate.

which CBS and other networks apply in making affiliation decisions (*e.g.*, R. 216-218, 222-224); (c) the issue was treated extensively in the briefs of both parties in the trial court; and, finally, (d) the "factors, *inter alia*" set out in the trial court's findings of fact as those considered by networks "in determining whether to end or to acquire a particular affiliation" included a comprehensive list which closely parallels the criteria set out in the CBS statement (pp. 29a-30a, *infra*).[26]

In short, there is nothing in the record to support the belief of the Court of Appeals that the trial court did not give the CBS policy statement the consideration it merited in the judgment of the Court of Appeals. On the contrary, it is clear that the trial court gave the CBS statement due consideration together with all other evidence bearing on the applicability of the general industry experience to the probability of renewal of the taxpayer's contracts.

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26. The trial court's list does not include the factor—emphasized in the opinion of the Court of Appeals (see p. 14a, *infra*)—of CBS reluctance to disturb an existing affiliation. However, that reluctance was a factor which had to be overcome in every termination of affiliation by CBS included in the statistical data, and thus could not distinguish the taxpayer's situation from the experience on which the statistical data was based. Of course, that experience shows a pronounced tendency to continue rather than terminate affiliations, resulting in the extremely high probability of renewal shown by the statistical calculations (see p. 18 n.17, *supra*). This tendency is given due weight in the fact that the average life shown by the life expectancy table is 20 years rather than some much shorter period.

B. The Court of Appeals was unjustified in ignoring the Treasury Regulation regarding "the general experience in the industry" to which the Tax Court had given extensive consideration.

Treasury Regulations §1.167(a)-1(b) (printed at pp. 1a-2a, *infra*) direct a reference to "the general experience in the industry" where the taxpayer's own "experience with similar property" is inadequate, as the Tax Court found to be the case here (see p. 45a, *infra*). In applying this Regulation, that Court analyzed the similarities among and the differences between the taxpayer's affiliation contracts and those of other television stations. It concluded that, for depreciation purposes, the similarities were more meaningful than the differences. In coming to this conclusion the Tax Court observed that the "controlling considerations relevant" were that the taxpayer's contracts were of the same type as those reflected in the industry experience and were subject to the "many and varied competitive economic forces such as gave rise to the prior terminations of such contracts" (p. 51a, *infra*).

The Tax Court pointed out that its own prior opinion and that of the Court of Appeals for the Third Circuit in the *Westinghouse* case[27] "reflect the premise that conclu-

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27. *Westinghouse Broadcasting Company*, 36 T. C. 912 (1961), *aff'd* 309 F. 2d 279 (3d Cir. 1962), *cert. denied* 372 U. S. 935 (1963). This is the only decided case other than the case at bar involving depreciation of network affiliation contracts. In *Westinghouse* it was held that the taxpayer there before the court had failed to introduce sufficient evidence of industry experience to establish the probability of renewals or estimated useful life of affiliation contracts.

Judge Train, who had written the opinion of the Tax Court in *Westinghouse*, was still a member of that court when the decision in the case at bar was reviewed by the court without dissent.

sions applicable to a specific [television affiliation] contract can be drawn from experience as to other contracts in the hands of other owners" (p. 52a n.11, *infra*). In dealing with the Commissioner's contention at trial that industry experience did not furnish a basis for forecasting an estimated life applicable to the taxpayer's contracts for depreciation purposes, the Tax Court noted that such a contention was inconsistent with the position taken in the Commissioner's own ruling on depreciation of network contracts (Rev. Rul. 57-377, 1957-2 C. B. 146). Thus, the court observed (p. 52a n.11, *infra*) that the Commissioner in his ruling had

> "found the existence of sufficient similarity in television affiliation agreements to permit promulgation of a ruling which was by its terms applicable to affiliation contracts throughout the industry."

While the Tax Court was aware that general industry experience would include instances containing factors tending to a shorter, as well as those tending to a longer, life expectancy than might be appropriate to this taxpayer (see p. 52a, *infra*), it noted that the theory behind the Regulation was that "these factors will tend to balance off, and that the statistically derived life expectancy, uniformly applied, will produce a result proper both for the taxpayers and the Government" (p. 53a, *infra*).

After pointing out that "depreciation requires only an estimate, not exactness," the Tax Court found that the taxpayer had offered "sufficient evidence, based on *general industry experience* over 15 years, to establish the 'average' lives of these network affiliation contracts with '*reasonable accuracy*' " (p. 51a, *infra*; emphasis in original).

In the concluding paragraph of its opinion, the Tax Court—a body specializing in tax controversies—found that reference to general industry experience in estimating life for depreciation purposes was both logical and practical. Thus, that court stated (p. 53a, *infra;* emphasis in original):

> "This rule permitting use of general industry experience is both logical and practical: *logical* because the national treasury cannot suffer from the use of a general average by a group of taxpayers; and *practical* because it alleviates the burden which would be placed on the courts to hear testimony of numerous witnesses regarding the detailed facts of other cases in the industry to determine case by case the degree of their similarity to the taxpayer's situation."

The Court of Appeals, making no reference at all to the Regulation regarding industry experience, dismissed the Tax Court's entire analysis of the purpose and effect of that Regulation in a single sentence, which concluded that "each contract is more unique than generic, which makes it questionable whether any meaningful general experience could ever be shown" (p. 9a, *infra*). However, the Court of Appeals—displaying the same inconsistency the Tax Court had noted with respect to the Commissioner's position on industry experience (see p. 32, *supra*)—asserted in a passage immediately adjacent to the one just quoted that the "facts of life of the television broadcasting industry" contain factors which "argue strongly for the perpetual duration of the contracts, at best, or at least for a wholely unpredictable life" (p. 9a, *infra*). Thus the Court of Appeals on the one hand found industry experience to be meaningless as the taxpayer sought to use it,

and on the other hand found it to be controlling against the taxpayer.

We suggest that underlying the inconsistency thus displayed in the positions taken with regard to industry experience by both the Commissioner and the Court of Appeals is an unarticulated premise that, while the statute and the Regulation regarding industry experience by their terms apply without distinction to tangible and intangible assets, they do not really permit the use of industry experience to forecast the average life of intangible assets. Such at least was the impression which the Court of Appeals opinion left with the authoritative commentators, Rabkin and Johnson. Thus, in their monthly *Federal Taxation Report, Taxes Today,* commenting on the instant case, they noted (Rep. No. 279, p. 47, October 1965):

> "The Treasury has long maintained that, for the purpose of an amortization deduction, there is some mysterious difference between a tangible asset and an intangible asset. The Treasury readily concedes that tangible property is depreciable on the basis of the best possible estimate of useful life; but for intangible property, it takes the position that the taxpayer is entitled to no deduction at all unless he can point to a particular date on the calendar as the day on which useful life ends. No court would deny depreciation on a newly-developed machine used by television broadcasters, on the ground that the industry is still in flux and no one really knows the useful life of such a machine. This decision of the Seventh Circuit is most deplorable because it nullifies the one decision [that of the Tax Court in the instant case] which had repudiated this unrealistic differentiation between tangible and intangible assets."

As Rabkin and Johnson indicate, resorting to an "estimate of useful life" on the basis of life expectancy tables should be permitted in the case of intangibles as well as tangibles. Indeed, this approach has long been used with respect to life estates, a type of intangible asset frequently encountered in the tax law. Thus, the Tax Court observed in the instant case (p. 46a n.8, *infra*):

> "Life expectancy tables for human beings, constructed on the basis of prior mortality experience, are used to determine the period over which a person purchasing a life estate in property may depreciate his cost for income tax purposes. See *William N. Fry, Jr.*, 31 T. C. 522 (1958) affirmed per curiam 283 F. 2d 869 (C. A. 6, 1960); and *Bell* v. *Harrison*, 212 F. 2d 253 (C. A. 7, 1954)."

Here the Tax Court used the same approach in allowing depreciation of the contracts at bar on the basis of a life expectancy table constructed from industry experience.

The basic issue in the present case—now ripe for decision by this Court—is whether the policy of the depreciation statute to allocate cost to the tax periods benefited by an asset shall be applied to the cost of acquiring business contracts, such as network affiliation contracts, which have a substantial probability of renewal and an average life which can be estimated with reasonable accuracy.

This basic issue not only involves a great number of taxpayers throughout the television industry, but has a

vital bearing on the tax rules applicable to intangibles in general. Its resolution by this Court is necessary to a sound and consistent administration of the tax law.

Conclusion

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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Appendix A

Treasury Regulations Involved

§1.167(a)-1. Depreciation in general.

(a) *Reasonable allowance.* Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(g) and §1.167(g)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. However, see section 167(f) and §1.167(f)-1 for rules which permit a reduction in the amount of salvage value to be taken into account for certain personal property acquired after October 16, 1962. See also paragraph (c) of this section for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value. See section 179 and §1.179-1 for a further description of the term "reasonable allowance."

(b) *Useful life.* For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, eco-

nomic changes, inventions and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year and shall be redetermined when necessary regardless of the method of computing depreciation. However, estimated remaining useful life shall be redetermined only when the change in the useful life is significant and there is a clear and convincing basis for the redetermination. For rules covering agreements with respect to useful life, see section 167(d) and § 1.167(d)-1.

(c) *Salvage.* * * *

[T.D. 6182, 1956-1 C.B. 98, 99, as amended by T.D. 6507, 1960-2 C.B. 91, 103, and by T.D. 6712, 1964-1 C.B. 106, 108.]

§1.167(a)-2. Tangible property.

* * *

§1.167(a)-3. Intangibles.

If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Ex-

amples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to good will. For rules with respect to organizational expenditures, see section 248 and the regulations thereunder. For rules with respect to trade mark and trade name expenditures, see section 177 and the regulations thereunder.

[T.D. 6182, 1956-1 C.B. 98, 101, as amended by T.D. 6452, 1960-1 C.B. 127, 128.]

Appendix B

Opinion of the Court of Appeals

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

No. 14954 SEPTEMBER TERM, 1964 — APRIL SESSION, 1965

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

INDIANA BROADCASTING CORPORATION,
Respondent.

Petition for Review of the Decision of the Tax Court of the United States

August 17, 1965

Before SCHNACKENBERG and CASTLE, *Circuit Judges,* and MERCER, *District Judge.*

MERCER, *District Judge.* The single contested issue presented on this petition is the question whether a tele-

vision network affiliation contract for a two-year term, which is automatically renewable, in the absence of termination by the affirmative act of either of the parties, for an unlimited number of successive two-year terms is a depreciable asset.

The purpose of the depreciation allowance permitted under the Code is to enable a taxpayer to recover the cost of a wasting asset used in his business by charging the diminution in the asset's value each year as a deduction from the gross income for that year. *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98; *Friend* v. *Commissioner,* 7 Cir., 119 F.2d 959, cert. denied 314 U. S. 673. The end to be achieved "is to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets." *Detroit Edison Co.* v. *Commissioner, supra,* at 101.

Intangible assets will not usually be a proper subject of the depreciation allowance unless the useful life of the asset is definitely limited or unless the intangible asset has value in the production of income for only a limited period of time, the duration of which can be estimated with reasonable accuracy. 26 CFR § 1.167(a)(3).[1] Although the Internal Revenue Code contains no specific reference to intangible assets in that regard, the Treasury Regulation, first adopted under the Revenue Act of 1918, remained substantially unchanged through successive reenactments of the Code and the Regulation has thereby acquired the force and effect of law. *Helvering* v. *Winmill,* 305 U. S. 79, 83;

1. The applicable Regulation provides:

"If the intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. * * *" 26 CFR, Sec. 1.167(a)(3).

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Old Mission Co. v. *Helvering*, 293 U. S. 289, 293, 294; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466.[2]

The Tax Court found that the contracts in issue were depreciable assets which could be depreciated by use of the straight line method over an estimated valuable life of twenty years. The Commissioner filed this petition to review that determination.

Taxpayer, Indiana Broadcasting Corporation, acquired all of the assets of WISH-TV in Indianapolis, and WANE-TV in Fort Wayne, Indiana, in November, 1956, by its purchase of all of the issued and outstanding stock of Universal Broadcasting Company, Inc., the prior owner of the two television stations. Among the assets acquired by the taxpayer were the two CBS[3] network affiliation contracts, one with respect to station WISH-TV and the other with

2. Applying the Regulation, the courts have allowed depreciation over the term thereof of the value of real estate leases and baseball player contracts, which, though renewable, could be renewed beyond the specified life of the contract only by renegotiation. *E.g.*, *Bonwit Teller & Co.* v. *Commissioner*, 2 Cir., 53 F2nd 381; *Commissioner* v. *Pittsburgh Athletic Co.*, 3 Cir., 72 F.2d 883; *Helvering* v. *Kansas City American Assoc. Baseball Co.*, 8 Cir., 75 F.2nd 600. Also recognized as proper subjects for depreciation have been street railway and motor coach franchises which were for fixed terms and not automatically renewable. *E.g.*, *Cleveland Railway Co.* v. *Commissioner*, 36 B.T.A. 208; *Pasadena City Lines, Inc.* v. *Commissioner*, 23 T.C. 34.

Examples of intangibles which have been held not to be the proper subject of a depreciation allowance are a F.C.C. broadcasting license, *KWTV Broadcasting Co.* v. *Commissioner*, 5 Cir., 272 F.2d 406; renewable liquor licenses and saloon permits, *Tube Bar Inc.* v. *Commissioner*, 15 T.C. 922, and *McAvoy Co.* v. *Commissioner*, 10 B.T.A. 1017, grazing permits, *Shufflebarger* v. *Commissioner*, 24 T.C. 980, and subscription lists, *Toledo Newspaper Co.* v. *Commissioner*, 2 T.C. 794.

3. The three existing television networks are designated throughout this opinion by the following initials: CBS for Columbia Broadcasting Company, and NBC for National Broadcasting Company, and ABC for American Broadcasting Company.

respect to station WANE-TV. Each of those contracts was dated March 30, 1956, and had been renewed prior to taxpayer's acquisition of the Universal assets for terms ending, respectively, on August 18, 1958, and September 26, 1958. Each contract provided that thereafter it would be automatically renewed for additional two-year periods, unless the contract was terminated in writing by either of the parties thereto not less than six months prior to its then termination date. Both of those contracts were still in force at the time of the trial of this action.

The consideration paid by the taxpayer for the Universal assets was $11,098,800.67. Of that amount the taxpayer allocated $4,000,000 to the CBS affiliation contract with WISH-TV and $625,000 to the CBS affiliation contract with WANE-TV. In each of its taxable years ending, respectively, on November 30, 1957, 1958 and 1959, taxpayer claimed deductions for depreciation on the $4,625,000 allocated to the CBS contracts. The Commissioner disallowed the deductions and assessed a deficiency against the taxpayer for each of those taxable years. The taxpayer filed a petition in the Tax Court for a redetermination of the deficiencies charged by the Commissioner.

At the trial below, the parties stipulated into evidence an 84-page exhibit which shows the history since 1948 of affiliation contracts of all television networks in each of 84 television market areas which had three or more television stations in operation on December 31, 1962. That exhibit showed the date when each station in each area began operation and the duration of all network affiliation contracts in each of the 84 areas.

Using that history, taxpayer's statisticians prepared a two-pronged life expectancy table, *i.e.*, the aggregate termination experiences reflected by all NBC and CBS contracts and the selected CBS experience. The latter was based upon CBS contract experience only for periods after which

in any market area there had been at least one other station in operation for at least twelve months, which was neither affiliated with NBC nor owned and operated by ABC. The latter area of experience was selected because it is limited to CBS contracts after there were sufficient stations in each particular market area to permit CBS to select between its affiliated station and at least one station which was neither owned by nor affiliated with either NBC or ABC.

Those tables showed 88 terminations of NBC and CBS affiliation contracts from 1948 through 1962, and, on the selected CBS side, 19 terminations of CBS affiliations from 1948 through 1962.

The theory of the statistical tables compiled was that an annual rate of contract termination for each pertinent period could be obtained by dividing the total number of years commenced by all of the affiliation contracts during a given period into the total number of contract terminations occurring during the same period. Using that termination rate, taxpayer's witnesses testified that the average life expectancy of any given contract could be determined by applying the Poisson-Exponential Theory of Failure. The crux of that theory is that the percentage of failure of items to which it is applied is a constant. For example, assuming a termination rate from the table of 5 percent per year, 95 percent of the whole group would survive at the end of one year, 5 percent of that 95 percent would fail to survive the second year and so on.

Adopting that theory, and applying it with some modification to the statistical history, the Tax Court found that an estimated useful life of the WISH and WANE CBS affiliation contracts could be determined with reasonable accuracy, and that use of the straight-line method over 20 years was a reasonable basis for depreciation of the contracts.

We think that the Tax Court erred in its findings that an estimated useful life of these contracts could be determined with reasonable accuracy.

The validity of the statistical analysis is more apparent than real because the analysis ignores the facts of life of the television broadcasting industry. Factors must be taken into account which show conclusively that these affiliation contracts, while in force, are not only not wasting assets but are assets of a constant, or even expanding, value. There are also factors which argue strongly for the perpetual duration of the contracts, at best, or at least for a wholly unpredictable life. We think those factors which we hereinafter explore show that each contract is more unique than generic, which makes it questionable whether any meaningful general experience could ever be shown.

There are 12 VHF[4] channels and 70 UHF[4] channels available upon which television broadcasting stations may operate. Those channels are variously allocated by the FCC[5] to particular cities or broadcast areas upon the basis of population and other factors. Each such channel may be utilized for commercial broadcasting pursuant to licenses granted to applicants by the FCC.

In 1945 there were 6 commercial television stations operating within the continental United States, all VHF. By September, 1948, the number of VHF stations had increased to 108, at which point a period of time known in the industry as "the freeze" began. From September, 1948, to July 1, 1952, the freeze period, the FCC processed no applications for television broadcasting licenses. The number of VHF commercial stations increased each year after the freeze was lifted to a total of 474 stations as of January 1, 1963.

4. Very High Frequency; Ultra High Frequency.

5. Federal Communications Commission.

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UHF licensing was first authorized by the FCC at the end of the freeze, and the number of the UHF channels in actual use has been variable, but limited.[6]

Relevant to this case the FCC allotted to Indianapolis four VHF channels, all now in use, and three UHF channels, none of which is in use. Fort Wayne was allotted four UHF channels, three of which are now on the air. WISH-TV began operating on July 1, 1954, and WANE-TV[7] began operating in September, 1954.

The revenue of television broadcasters is derived from charges for broadcast time paid by advertisers. The rates charged by stations for advertising time vary from area to area, and from station to station within a given area, according to the estimated size of the audience of the particular station. The charges of a single station may vary according to its usual audience for different hours of the day. Therein lies the value of network affiliation; attractive programs draw a large audience, a large audience attracts advertisers and advertisers are revenue.

The sources of available programming are three-fold, namely, locally produced programs, motion pictures and other filmed material purchased by a station from distribution sources other than the networks and network programming. The latter is of two types, namely, sponsored network programs and non-sponsored, or sustaining, programs furnished by the networks to their affiliated stations.

Throughout the history of television, network programs have been the most valuable source of programming for

6. Because few early television receivers were equipped to receive UHF broadcasts, UHF stations in operation reached a high of 121 stations in 1954, and then declined in number to 76 stations in 1960. By January 1, 1963, the number of such stations had increased to 90 under the impetus of legislation and rules requiring all channel capability for new television receivers.

7. First licensed as WINT-TV.

a station. Their value is three-fold. First, network programming tends to have a national audience appeal which attracts a large number of viewers. Secondly, network programs are delivered to affiliated stations without charge,[8] whereas a non-affiliated station must produce or purchase all program material at substantial cost.[9] Finally, it is frequently impossible for a non-affiliated station to buy programming at any cost which can compete effectively against the network programs.

At all material times, CBS was the dominant network in audience appeal, with NBC and ABC following in that order.

Thus a network affiliation contract is something of value, and a CBS affiliation contract is something of the greatest value in any given market area.[10] At the time of the trial of this case, the value of a CBS contract was essentially equivalent to the value of all of the other combined assets of an operative station owning such a contract.

It seems, therefore, certain that any non-affiliated station now on the air, or any station which might begin operating, in taxpayer's market areas would covet taxpayer's affiliation contracts. However, the side of the slate which taxpayer's witnesses omitted from their opinion testimony, and which we believe the court below omitted

8. There is no charge for programming, except that for recorded programs, the networks do charge the affiliated station for the recording furnished.

9. In a given market area, the cost of the operation of various stations, exclusive of the cost of programs, is substantial and approximately equivalent. This factor then has a very real bearing upon the profits to be realized by a station.

10. Assuming all other factors to be equal, including the facilities to reach an audience, the Indianapolis experience of 1958 indicates a basis for comparison. In that year WISH-TV had net income of $1,195,695, as compared to $754,000 for the NBC affiliate, $199,777 for the ABC affiliate and a loss of $241,293 for a non-affiliated station.

from its evaluation of the evidence, militates strongly against the success of any covetous overtures to CBS by any competing station.

The first element which the court below overlooked is the state of flux which has affected this young industry,[11] with its consequent effect upon the industry history of contracts. Through the freeze period it was not uncommon for a single station to have affiliation contracts with two or more networks.[12] There simply were not enough stations in many areas, and the networks found outlets for their programs where they could, even if they had to share the spotlight with one or more competing networks. As new stations came on the air after the freeze a large number of affiliation contracts were terminated as the networks sought exclusive area affiliations. In the period 1953 to 1955 which immediately followed the freeze 49 NBC and CBS contracts were terminated.[13] All of those terminations entered into the statistical analysis of the aggregate experience and many of them affected the selected CBS statistics. The stipulated exhibit strongly suggests that the period of flux yet continues in the industry, and that it colors the industry history to such an extent that there is grave doubt that any reliable norm of contract expectation could be found at this time. We think it certain that any such norm built upon the evidence in this case would be pure guesswork, and we see no statistical validity in the life expectancy tables upon which the decision below rests.

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11. Though a few stations began commercial operation in 1945, 1948 may be called the year of the birth of the industry.

12. WISH-TV was affiliated with NBC, ABC and the now inoperative Dumont Network, as well as with CBS, in its first year of operation. WANE-TV was affiliated with both CBS and ABC from 1954 to 1957.

13. That number represents about 55 percent of the terminations considered in compiling the life expectancy tables adopted by the court below.

It is likewise clear that the stipulated exhibit graphically refutes the existence of a basic premise upon which the Poisson theory relies, namely, that the life expectancy of all contracts is the same regardless of the length of duration of the contract. Of the 88 contract terminations included in taxpayer's aggregate experience analysis, 50 percent were terminated before they had been in force for four years, and 80 contracts, or approximately 91 percent of the group, were terminated before they had been in force for seven years.[14] Only three of those contracts were terminated after they had been in force for more than nine years. Of those three, one was terminated by the local station, not by the network. A second, terminated by CBS, was the contract of a station affiliated with both CBS and NBC, and located in a market area in which CBS had then contracted an exclusive affiliation with another station. The record contains no hint as to the background for the termination of the third of those contracts. The summary of industry history is undoubtedly subject to varying interpretations, each of arguable validity, but we think it necessary to conclude that the premise that a contract in its ninth year, for example, is no more immune from termination than is a contract in its first year is not one of such arguable interpretations. A very high degree of stability is reflected in the history of contracts which have continued in force for more than eight or nine years. Whatever its worth in other areas, the Poisson-Exponential theory has no application in this case.

Another factor which taxpayer's statistician did not consider at all[15] and a factor which the court below largely

14. No reason for termination is shown as to any of those contracts, though the timing of the termination does suggest that a very substantial number of them were terminated when exclusive affiliation facilities first became available to the networks.

15. He professed to have no knowledge of the television industry in general and of network affiliation practices in particular. He testified that he based his evaluation and testimony solely upon the data contained in the contract-history exhibit.

overlooked, is the CBS policy in the renewal of its contracts.

CBS policy, as outlined by a network bulletin in evidence, stresses "present affiliation with a station" as a "substantial factor" governing the CBS decision when any contract is ripe for renewal because of general business considerations and because an audience tends to associate the network with its established outlet. CBS is "reluctant to disturb" the existing affiliation, and, unless a new station shows "substantial superiority in significant areas, the fact of present affiliation controls."

Factors deemed significant by CBS in determining questions of affiliation with a local station are the station's clearance of network programs for broadcast,[16] the qualifications of management, including newspaper ownership of the station, multiple station ownership and location of the station in the principal city of its market area.

The record reveals that taxpayer is managed by experienced persons in the field, and that it is owned in common with the New York Herald-Tribune and three other corporations operating television stations in Tulsa, Houston and Sacramento.[17] Its stations are located in the principal cities of its respective market area.[18] Its stations have a record of broadcasting network programs about 63 percent of their total broadcast time and during an average 95 percent of

16. Non-clearance and delay of broadcast of network programs evidencing a disinterest in those programs which unreasonably impairs the ability of CBS to serve national advertisers will "generally" outweigh the disadvantages of disrupting an existing relationship because of the network's need "to effect substantial clearance."

17. All of those stations are affiliated with CBS under contracts ranging in date from November, 1949, to March, 1955.

18. Of present significance, the only non-affiliated station in the Indianapolis market area is located outside the City of Indianapolis. The record reveals that that station has had contracts with NBC and ABC terminated for that reason as new stations began broadcasting from Indianapolis, the central city of the market area.

the "prime time" hours.[19] Though the factor of contemporaneous ownership of CBS-affiliated radio facilities is now considered inconsequential by CBS, it may be noted that taxpayer operates radio stations affiliated with CBS in both Indianapolis and Fort Wayne.[20]

Clearly taxpayer attached substantial significance to the renewal prospects of its contracts and purchased the stations with the expectation that the contracts would be continued in force indefinitely. It appears that that expectation will be realized by it in the light of the already substantial duration of the contracts and of pronounced CBS policy governing contract renewals. There is nothing to suggest that CBS will change its policy, or that at any reasonably predictable time the one party or the other will cause the contracts to be terminated. Moreover, unlike an asset having a declining value with the passage of time, these contracts probably will have a constant value, or even an increasing value, in years to come.

In the single previous case dealing with the issue before us it was held that the taxpayer had failed to adduce any evidence to prove that network affiliation contracts had a useful life capable of reasonable calculation. *Westinghouse Broadcasting Co.* v. *Commissioner*, 36 T. C. 912, aff'd 3 Cir. 309 F.2d 279, cert. denied 372 U. S. 935. Taxpayer argues that the stipulated industry-history exhibit supplies the deficiency held to exist in *Westinghouse*. There is no merit to that position. That exhibit suggests, and the record as a whole persuasively indicates, that taxpay-

19. From 7:30 p.m. through 11:00 p.m.

20. Whatever significant relationship the selected CBS experience may bear to taxpayer's situation, particularly in Indianapolis, the table is meaningless because it lacks any reference to the cardinal factor of the reason for the several terminations included therein. Without knowledge of the reason for each contract termination, there is totally lacking any basis for the comparison of taxpayer's situation to the situation which evoked any of those several CBS terminations.

er's contracts may be expected to remain in force for a wholly unpredictable period of time.

We think that a close analogy to this case is found in *Nachman* v. *Commissioner,* 5 Cir., 191 F.2d 934. There the taxpayer paid $8,000 for a city liquor license having five months of a one-year term unexpired. Although the license itself contained no provision relative to renewal, the evidence indicated that the city, in issuing licenses from year to year, gave preference to holders of existing licenses over other applicants for the limited number of licenses authorized. The court affirmed the Tax Court's decision holding, inter alia, that the license was indefinite in duration and, therefore, a non-depreciable capital asset.

The *Nachman* rationale was applied in *Gant* v. *Commissioner,* 6 Cir., 263 F.2d 558,[21] *KWTX Broadcasting Co.* v. *Commissioner,* 5 Cir., 272 F.2d 406,[22] and *Coca Cola Bottling Co.* v. *Commissioner,* 6 B.T.A. 1333.[23]

We think that the reasoning of those cases is sound and that the present case cannot be factually distinguished therefrom. Where there is no reasonable basis for the prediction of the expected valuable life of an intangible asset, it follows that the asset is not the proper subject of depreciation allowance.

The Tax Court's findings that the estimated useful life of these contracts is ascertainable with reasonable certainty and that these contracts are depreciable assets are clearly erroneous. The decision of the Tax Court is therefore reversed.

REVERSED

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21. That case involved a gasoline distributorship agreement for a fixed term which contained no specific renewal covenant except the customary usage in the trade.

22. This case involved a three year FCC license to operate a television station, and the factor that the FCC had never refused to renew an existing license.

23. This case involved a Coca Cola franchise with no guarantee of renewal except industry practice.

Appendix C

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Tuesday, August 17, 1965

Before

Hon. ELMER J. SCHNACKENBERG, Circuit Judge
Hon. LATHAM CASTLE, Circuit Judge
Hon. FREDERICK O. MERCER, District Judge

No. 14954

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

INDIANA BROADCASTING CORPORATION,
Respondent.

Petition for review of a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on May 12, 1964, be, and the same is hereby, REVERSED, in accordance with the opinion of this Court filed this day.

Appendix D

Decision of the Tax Court

TAX COURT OF THE UNITED STATES

INDIANA BROADCASTING CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 95414. Filed March 13, 1964

Petitioner acquired on November 30, 1956, the CBS network affiliation contracts of WISH-TV in Indianapolis and WANE-TV in Fort Wayne in connection with its acquisition of the assets of these stations. The total basis for all the assets was $11,098,800.67. The network affiliation contracts were for 2-year terms, automatically renewable for successive 2-year terms unless either party gives 6 months written notice of intention not to renew. The contracts are still in force.

Held:

1. That of the total basis for the assets acquired by petitioner, $4,625,000 represented the cost of the two network affiliation contracts, of which $4,000,000 was properly allocated to the WISH-TV CBS contract and $625,000 to the WANE-TV CBS contract.

2. That the two network affiliation contracts do not constitute goodwill.

3. That the segments of general experience in the television industry selected and analyzed by petitioner's expert witnesses provide an adequate basis upon which to construct a life expectancy table applicable to petitioner's network affiliation contracts.

4. That from the statistical data and analyses in evidence, and pursuant to sec. 167(a), I.R.C. 1954 and the regulations promulgated thereunder, the estimated useful life of petitioner's network affiliation contracts can be determined with the degree of accuracy required for depreciation purposes; and that use of a straight-line method over a period of 20 years constitutes a reasonable allowance for depreciation.

Edwin S. Cohen, Whitman Knapp, Donald Schapiro, and *Martin F. Richman,* for the petitioner.

George H. Becker, for the respondent.

DAWSON, *Judge:* Respondent determined the following deficiencies in petitioner's income tax:

Taxable year ended—	*Deficiency*[1]
November 30, 1957	$743,277.99
November 30, 1958	655,747.87
November 30, 1959	775,394.42

One issue has been disposed of by agreement of the parties and will be reflected in the Rule 50 computation.

The issues presented for decision are:

1. Whether the basis to petitioner of the two network affiliation contracts with the Columbia Broadcasting System was at least $4,625,000 and properly allocated to the

1. If the respondent prevailed in this proceeding, the total deficiencies for the 3 years at issue would be approximately $2,200,000. Adoption of petitioner's position, as set forth in the opening statement of its counsel and in its brief which contends for depreciation deductions based on a 14-year straight-line method, would result in aggregate deficiencies for the 3 years of about $1,600,000.

WISH-TV and WANE-TV contracts in the respective amounts of $4,000,000 and $625,000.

2. Whether the network affiliation contracts of WISH-TV and WANE-TV constituted the going concern value of petitioner's business or its customer structure, viz., goodwill.

3. Whether petitioner, who acquired the network affiliation contracts with the Columbia Broadcasting System in the purchase of television broadcasting stations WISH-TV and WANE-TV, is entitled to depreciation deductions of the cost of such contracts over a period, which takes into account possible renewals of their existing terms, calculated on the basis of a life expectancy table developed by recognized statistical methods from industry experience as to renewal or termination of such contracts.

Findings of Fact

Some of the facts and exhibits have been stipulated and are incorporated herein by this reference.

Indiana Broadcasting Corporation (hereinafter called petitioner) is a corporation organized under the laws of the State of Delaware with its principal office located at 1440 North Meridian Street, Indianapolis, Indiana.

Petitioner filed its Federal income tax returns for the taxable period July 20, 1956, to November 30, 1956, and for the taxable years ended November 30, 1957, November 30, 1958, and November 30, 1959, with the district director of internal revenue at Indianapolis. Its books of account were maintained, and its Federal income tax returns prepared, on the basis of the accrual method of accounting and a fiscal year ended November 30.

By agreement dated July 26, 1956, petitioner contracted to purchase all of the issued and outstanding stock of Uni-

versal Broadcasting Company, Inc., subject to the approval of the Federal Communications Commission (hereinafter called FCC) for the aggregate price of $10,000,000. This purchase of the Universal stock was approved by the FCC on October 10, 1956, and petitioner acquired the stock on November 15, 1956, at a total cost, including commissions and other acquisition expenses, of $10,208,165.89.

At the time of petitioner's acquisition of the Universal stock, Universal owned and operated television station WISH-TV and radio station WISH in Indianapolis. Universal also owned all of the stock of Tri-State Television, Inc., an Ohio corporation, which owned and operated television station WINT in the Fort Wayne, Indiana, area. The call letters WINT were later changed to WANE by petitioner with FCC approval effective April 1, 1957. (WANE-TV rather than WINT-TV will be used throughout the findings of fact and opinion in this case.) In addition, Universal owned all of the stock of Radio Fort Wayne, Inc., an Indiana corporation, which owned and operated radio station WANE in Fort Wayne.

On November 29, 1956, Tri-State Television, Inc., and Radio Fort Wayne, Inc., were merged into Universal, which thereupon acquired all of their assets and assumed all of their liabilities.

On November 30, 1956, Universal was merged into petitioner, which thereupon acquired all of Universal's assets and assumed all of its liabilities. Consequently, petitioner acquired all of the assets and assumed all of the liabilities involved in the ownership and operation of television station WISH-TV and radio station WISH in Indianapolis and television station WANE-TV and radio station WANE in Fort Wayne.

It is stipulated that, after giving effect to liabilities of Universal assumed by petitioner, the total basis of the assets owned by petitioner after the acquisition of assets from Universal on November 30, 1956, was $11,098,800.67.

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And that after adjustments by respondent, agreed to by petitioner, such basis is properly allocated among such assets as follows:

Cash	$1,300,988.25
Notes and accounts receivable	471,159.64
Prepaid expenses and supplies	258,819.83
Depreciable tangible property	1,932,794.17
Land	106,835.00
Leasehold costs	372,303.33
Organization expense	26,575.12
All other assets, including television network affiliation contracts	6,629,325.33
	$11,098,800.67

The amount of $6,629,325.33 indicated above as the proper basis for all other assets, including television network affiliation contracts, acquired by petitioner consists of the sum of (a) amounts allocated by petitioner on its books of account as follows:

Network affiliation contracts:

WISH-TV affiliation contract with CBS	$4,000,000.00
WINT affiliation contract with CBS	625,000.00
WINT affiliation contract with ABC	125,000.00
Goodwill and other intangible property, including FCC television and radio broadcasting licenses and CBS radio network affiliation contracts with WISH and WANE radio	1,450,842.00

and (b) adjustments by respondent agreed to by petitioner increasing the aggregate amount of the above items by $428,483.33.

Among the assets acquired by petitioner from Universal were television and radio network affiliation contracts with

the Columbia Broadcasting System (hereinafter called CBS) with respect to station WISH-TV and WISH radio in Indianapolis and with respect to television station WANE-TV and radio station WANE in Fort Wayne, and a television network affiliation contract with the American Broadcasting Company (hereinafter called ABC) with respect to television station WANE-TV.

The CBS affiliation contract of WISH-TV was an agreement dated March 30, 1956, which prior to petitioner's acquisition had been renewed for a term ending August 18, 1958.

The CBS affiliation contract of WANE-TV was an agreement dated March 30, 1956, which had previously been renewed for a term ending September 26, 1958.

The ABC network affiliation contract of WANE-TV was an agreement dated October 26, 1956, for a term ending September 29, 1957.

Pursuant to provisions of the affiliation contracts, CBS and ABC consented in writing to the transfer of the respective affiliation contracts to petitioner and petitioner assumed the obligations of the contracts.

The term of the ABC affiliation contract of WANE-TV ended September 29, 1957. No further affiliation contract was entered into by petitioner and ABC.

The CBS affiliation contract of WANE-TV was amended by letter agreement dated September 27, 1957, and by a revised contract form dated March 13, 1958.

The CBS affiliation contracts of WISH-TV and of WANE-TV were renewed in 1958 for 2-year terms ending, respectively, August 18 and September 26, 1960. Both contracts were thereafter successively renewed for additional 2-year terms ending on the same dates in 1962 and 1964.

On December 1, 1956, petitioner on its books of account began amortizing the basis of $4,000,000 allocated to the CBS affiliation contract of WISH-TV and the basis of

$625,000 allocated to the CBS affiliation contract of WANE-TV, in equal monthly installments, taking as the period of amortization the respective remaining terms of the affiliation contracts (21 months to August 1958 in the case of WISH-TV and 22 months to September 1958 in the case of WANE-TV).

In February and March 1958, when the contracts were respectively renewed for additional 2-year terms, petitioner commenced to amortize the then-remaining unamortized balance of the basis of each contract in equal monthly installments over the remaining periods of the contracts as thus extended (30 months to August 1960 in the case of WISH-TV and 30 months to September 1960 in the case of WANE-TV). Petitioner took deductions for amortization in accordance with the foregoing method of amortization on its tax returns for the taxable years ended November 30, 1957, 1958, and 1959.

Television broadcasting stations operate on channels assigned by the FCC. There are 12 very high frequency or "VHF" channels, numbered 2 to 13, and 70 ultra high frequency or "UHF" channels, numbered 14 to 83. Varying numbers of channels are allocated to particular cities by the FCC on the basis of population, distance from other cities, and other factors. Each allocated channel for commercial broadcasting may be utilized by a television station pursuant to a license granted by the FCC, with the usual term of such broadcasting licenses since 1955 being 3 years.

Six commercial television stations were operating in the United States in 1945. On September 30, 1948, the FCC stopped processing applications for new television station construction permits, and did not resume processing such applications until July 1, 1952. This period was referred to in the television industry as the "freeze." At the end of the freeze there were 108 VHF commercial television stations in operation, and the number of VHF commercial

television stations in operation on January 1, of each succeeding year has grown each year, to 474 stations on January 1, 1963.

Prior to the end of the freeze, there were no UHF commercial television stations and all television sets manufactured for sale to the public could receive only VHF stations. At the end of the freeze the FCC authorized the use of UHF channels for commercial broadcasting, and by January 1, 1954, there were 121 UHF commercial stations on the air. However, in the postfreeze period most television sets still were manufactured to receive only VHF stations, so that the owner of a VHF set had to purchase and install a UHF converter of some type in order to be able to receive UHF stations. The number of UHF commercial stations in operation declined annually to a low of 76 by 1960, as did the percentage of television sets manufactured to receive all television channels. But, pursuant to the long-established policy of Congress and the FCC to encourage the use of UHF to increase the number of commercial television stations, an objective toward which efforts had been made prior to 1956, the Congress in 1962 enacted the "All-Channel Receiver Law" (Public Law 87-529), which authorized the FCC to make rules requiring that all television sets shipped in interstate commerce be capable of receiving both VHF and UHF stations. The FCC has adopted such rules, to take effect April 30, 1964.

The number of UHF stations on the air had increased to 90 by January 1, 1963, and the percentage of sets capable of receiving UHF manufactured in 1962 increased substantially over the immediately preceding year. It has been estimated that the replacement of existing television receivers by newly-manufactured sets will result by 1970 in most of the television sets actually in use being equipped to receive UHF. This development, together with other factors, is expected to encourage the construction of UHF

stations in market areas heretofore served only by the more limited number of VHF stations.

Network operations in television began on a large scale basis in 1948 with the opening of extensive "interconnection" facilities of the American Telephone and Telegraph Company for transmission of television programs between cities by means of coaxial cable and, later, by microwave relay. Interconnection by means of these facilities reached Indianapolis in 1950 and Fort Wayne in 1954.

There are three national television networks: the Columbia Broadcasting System (CBS), the National Broadcasting Company (NBC), and the American Broadcasting Company (ABC). Network operations of Alan B. Du Mont Laboratories, Inc., ceased in September 1955.

The FCC allocation of channels for commercial broadcasting in the Indianapolis-Bloomington market area (Bloomington being about 45 miles to the southwest of Indianapolis) consists of the four VHF channels presently on the air, namely, WFBM-TV, WTTV, WISH-TV, and WLWI. There are also three UHF channels, none of which is in use.

In 1949, station WFBM-TV began commercial broadcasting in Indianapolis and station WTTV began broadcasting from Bloomington. WISH-TV came on the air in Indianapolis on July 1, 1954, as did station WLWI in October 1957.

A number of changes in affiliation between the networks and the stations in the Indianapolis-Bloomington market area occurred before 1956. When petitioner acquired WISH-TV in November 1956, it was affiliated only with CBS. WFBM-TV was affiliated only with NBC and WTTV was affiliated with ABC. When WLWI came on the air in October 1957, ABC commenced affiliation with that station and the ABC affiliation of WTTV was termi-

nated. WTTV has not had a network affiliation since that time.

The FCC allocation of commercial channels for Fort Wayne consists of the three UHF channels now on the air, namely, WKJG-TV, WANE-TV, and WPTA, and one additional UHF channel not in use.

WKJG-TV commenced commercial television broadcasting in Fort Wayne in November 1953. It has been affiliated with NBC since it came on the air and was also affiliated with ABC during its first year. In September 1954 station WINT (WANE) came on the air. It has been affiliated with CBS since then and was also affiliated with ABC from October 1954 to September 1957. Station WP TA came on the air in September 1957 as an ABC affiliate.

Petitioner's stock is held in common ownership with that of three other corporations operating television stations in Tulsa, Houston, and Sacramento. These stations, known in the television industry as the "Corinthian Stations," are each affiliated with the CBS television network. A major share of the stock of Corinthian is owned by Whitney Communications Corporation whose controlling stockholder and chairman of the board is John Hay Whitney. The New York Herald-Tribune has been under common ownership with petitioner since August 1958.

The terms and conditions of the affiliation between a network and a station are defined in each case in a network affiliation contract. Although the contracts of particular stations are individually negotiated and there may be variations from the standard provisions, the three networks each have basic forms of affiliation contracts.

The pertinent provisions of the network affiliation contract between CBS and WISH-TV in effect at the time of petitioner's acquisition may be summarized as follows:

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1. The contract recited that the parties "recognize that the regular audience of Station will be increased, to their mutual benefit, if CBS Television provides Station with television programs not otherwise locally available."

2. CBS agreed to offer WISH-TV for broadcasting by that station (a) CBS network sustaining (i.e., non-sponsored) programs and (b) CBS network sponsored programs (i.e., programs sold by CBS television for sponsorship by its client-advertisers) for which such advertisers may request broadcasting by the station.

3. The station has a right of "first refusal" of each network sponsored or sustaining program good against any television station licensed to operate in the same community.

4. Subject to specified limitations, the station agreed to accept and broadcast all network sponsored programs offered to it for broadcast during certain hours of the day known as "network option time." (On May 28, 1963, the FCC amended this rule to prohibit network option time, effective September 10, 1963.)

5. CBS agreed to pay the station for broadcasting sponsored programs 30 percent of the gross rates charged to sponsors by CBS for the broadcasting time of the station, less certain deductions specified in the affiliation contract.

6. CBS also agreed to furnish sustaining programs delivered to the station by coaxial cable or microwave relay facilities without charge, but where such programs were delivered in the form of TV recordings, the station agreed to pay CBS's charges for the recordings.

7. The affiliation contract further provided that "unless either party shall send notice to the other at least six months prior to the expiration of the then current two-

year period that the party sending such notice does not wish to have the term extended beyond such original period, the term of this Agreement shall be automatically extended upon the expiration of the original term and each subsequent extension thereof for an additional period of two years; and provided further, that this Agreement may be terminated effective at any time by either party by sending notice to the other at least twelve months prior to the effective date of termination specified therein."

The network affiliation contract between CBS and WANE-TV contained provisions identical with those of the WISH-TV CBS contract just described. Both contracts were substantially similar to the form of CBS contract generally in use at the time. The provisions of network affiliation contracts of the NBC and ABC networks were generally comparable to those of the CBS contracts.

Affiliation contracts are generally made for a term of 2 years, subject to automatic extension of additional 2-year terms if neither party gives notice a specified time in advance of the termination date. As in the case of the WISH-TV contract, the initial term may be a shorter period in order to conform to a prior anniversary date. Under the Chain Broadcasting Rules of the FCC (applicable to radio since 1941 and to television since 1945), the maximum term of a network affiliation contract is 2 years, provided that such 2-year term may be entered into or renewed not more than 6 months in advance of commencement of any 2-year term.[1]

Networks, including CBS, consider many factors in determining whether to end or to acquire a particular affiliation. These factors, *inter alia,* include the following: coverage of concentrated market by the station; whether the station is in the central city or whether it is located outside of the city; whether the station is controlled by a mul-

1. See 47 C.F.R., Sec. 3.658(c).

tiple owner with considerable experience in the field; whether the multiple owner has other stations in other markets which are desirable; whether the station is controlled by an owner who has interest in the newspaper field; the nature of the working relationship between the station and the network; clearance of network programs for broadcast, relative share of audience; qualifications of management; and certain intangible and psychological factors, including the general personal impression which the owners and managers of a proposed affiliate make on the CBS television network personnel who make the decisions, expressions of Congressional and other official interest, and public reaction.

Substantially all the revenue of a television station is provided by charges for broadcast time paid by advertisers, who in buying such time are interested in the opportunity to present their advertising messages to the largest audience possible for the cost incurred. Thus the rates charged by a station will vary with the estimated size of the audience viewing the station—varying from community to community according to their size, from station to station within a community according to the typical audience of the stations, and varying for a particular station according to the normal audience for different times of the day.

Since the station's revenue depends on the size of the audience it is able to reach, a station makes efforts to get the largest possible viewing audience. The primary factor in securing a high audience level is programing, that is, securing programs that will attract more viewers than the programs of the competing stations. In this competitive effort, there are two basic sources of programs, network programs and local programs, the latter category including not only programs actually produced locally but also film programs produced in Hollywood for other television centers and delivered to the station on film.

Throughout the whole history of television, including the years in issue in this case, network programs have been the most important source of programing for a television station. For example, WISH-TV during these years had an average broadcasting day of 17½ hours, during which network programs were televised for an average of approximately 11 hours daily, or about 63 percent of total broadcast time. During the 3½ hours of evening "prime time" (from 7:30 to 11 p.m.) network programs were televised on the average of 95 percent of the time. This substantial extent of the broadcasting of network programs was then typical of affiliated stations in markets the size of Indianapolis, and approximately the same conditions continue today.

Statistical data shows that in the years 1956 through 1959, CBS was the dominant network in terms of audience appeal or audience level, i.e., the number of homes or viewers watching programs. For the year 1955, network program time sales of stations affiliated with CBS were 121 million dollars, of stations affiliated with NBC were 106 million, and of stations affiliated with ABC were 26.5 million dollars. According to the statistics submitted, CBS is still the leading network in audience level and dollar sales.

A station's revenue from network program time sales provides only part of its total revenue. For example, petitioner's total television income from WISH-TV for the year ended November 30, 1957, was $3,288,821.45, of which $869,025.13, or about 26 percent was derived from network program time sales. On the other hand, a total of $2,296,-865.35, or approximately 70 percent of the total television income, was derived from prime sales for non-network programs and announcements. The revenue from announcements alone was about 54 percent of the total tele-

vision revenue. The figures for the 2 succeeding years at issue show approximately the same relationship. The figures for WANE-TV are similar, although in that smaller market network program revenue accounted for an average of about 35 percent of total television income during these years. On a nationwide basis, market financial data published by the FCC reveal that the revenue of affiliated stations from network program time sales averages around 25 percent of total revenue.

The revenue to a station from network program sales is received from the network as the station's share, computed in accordance with the affiliation contract, of the time charges paid to the network by the advertisers for the broadcast time of the particular station. However, the revenue for non-network programs and announcements comes not from the network but directly from the advertisers as a result of time sales made by the station's advertising salesmen or its national sales representative. The substantial revenue from announcements is derived from broadcasting brief advertising messages in the "break" which occurs between programs or between segments of longer programs.

During evening "prime time," when the viewing audience is at its largest and a station like WISH-TV is broadcasting network programs for almost the entire period, the announcements will usually occur adjacent to network programs or in the "break" within a network program. Consequently, in a typical hour of evening "prime time" WISH-TV derived about $500 revenue for the 58 minutes, 50 seconds of a network program and approximately $1,200 from the sale of several announcements totaling some 70 seconds of time. In view of the interest of the advertisers in securing the maximum audience for the advertising messages broadcast in these announcements, and the effect of network programing in attracting a large audience, the au-

dience appeal of the network programs has an important effect upon the revenues a station can derive from announcements, even though the station sells such announcements independently of the network.

While an affiliated station has available to it a substantial program service with large audience appeal, furnished by the network with no dollar outlay by the station, an unaffiliated station must pay for its programing, a factor of substantial impact on profits of an unaffiliated station. Moreover, it may be impossible for the unaffiliated station to buy programing at any price that will compete effectively with affiliated stations for audience.

As between affiliated stations in the market area, since the costs of operation of a television station are substantial, and roughly equivalent as among the stations, the amount of their respective revenues has a substantial bearing upon profits. During the years in issue the greater audience appeal of CBS programs, and consequent high revenues of CBS-affiliated stations, resulted in the profit of the CBS-affiliated station typically being greater than that of the competing ABC-affiliated station.

The price of $10,000,000 for the stock purchased by petitioner was negotiated at arm's length. If WISH-TV and WANE-TV had had network affiliation contracts only with ABC, rather than with CBS, the value of the stock purchased would have been less than $5,000,000 and without any affiliation contracts for the television stations the stock would have been worth still less. The $5,000,000 difference in value is attributable to the value of the CBS affiliation contracts. According to the prevailing price-earnings ratio for television stations in 1956, the fair market value of a station was approximately 6 times its annual earnings before taxes.

The broadcast net income before taxes of the Indianapolis-Bloomington television stations, as reported by the sta-

tions to the FCC, for the calendar years 1956, 1957, and 1958 were as follows:

Year	Station	Network affiliation	Broadcast net income
1956	WISH-TV	CBS	$1,479,492
	WFBM-TV	NBC	843,000
	WTTV	ABC	86,265
1957	WISH-TV	CBS	$1,263,497
	WFBM-TV	NBC	813,000
	WLWI (on air 2 months)	ABC	(220,872)
	WTTV	(ABC 10 months.) (None 2 months.)	68,589
1958	WISH-TV	CBS	$1,195,695
	WFBM-TV	NBC	754,000
	WLWI	ABC	199,777
	WTTV	None	(241,293)

Thus the net income of WISH-TV for each of the 3 years was roughly $1,000,000 or more in excess of the net income of the station affiliated with ABC, while the unaffiliated station in 1958 operated at a substantial loss.

The basis to petitioner of the CBS affiliation contract with WISH-TV alone was not less than $4,625,000 allocated by petitioner to the CBS contracts of both WISH-TV and WANE-TV in its books of account and on its Federal income tax returns. This basis was reasonably allocated between the two contracts in the respective amounts of $4,000,000 to the CBS affiliation contract of WISH-TV and $625,000 to the CBS affiliation contract of WANE-TV, particularly in view of the relationship of the value of $1,500,000 placed on WANE-TV in 1956 to petitioner's total purchase price of $10,000,000.

Exhibit 19-S stipulated by the parties, shows the facts with respect to the history of television network affiliations in each of the 84 television market areas which had three or more operating commercial television stations on December 31, 1962, including the dates of commencement and

termination, and thus the duration, of all network affiliations between these stations and each of the networks during the years 1948 through 1962. For this period there were 250 affiliations of stations in these markets with either CBS or NBC, excluding stations owned and operated by these networks. Of this total, 134 affiliations were with CBS and 116 were with NBC.

The useful life of petitioner's network affiliation contracts for depreciation purposes in the taxable years in issue could properly be estimated by taking into account two segments of industry experience reflected in the historical data as to termination of the network affiliations set forth in Exhibit 19-S: (1) the experience with respect to all 250 CBS and NBC affiliation contracts in the 84 markets (aggregate experience); and (2) the experience with respect to CBS affiliation contracts in these markets during periods after which there had been at least one other station in the market for a minimum period of 12 months that was neither affiliated with NBC nor owned and operated by ABC (selected CBS experience).

The statistical data regarding aggregate experience and selected CBS experience is consistent with the Poisson-exponential theory of failure, a statistical method widely used in the determination of life expectancy and useful lives of various types of properties, including materials subject to physical failure (*e.g.*, vacuum tubes, loading coils, and restaurant tumblers) as well as in the determination of probability of occurrence of human actions. The characteristic of items whose failure or termination rate is consistent with the Poisson-exponential theory is that the proportion or percentage of those that will fail in a given period of time is constant, that is, if the rate is 5 percent per year, at the end of 1 year 95 percent of the original group will have survived, 5 percent of this 95 percent will fail to survive the second year, 5 percent of the survivors at that time will fail to survive the third year, etc.

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The actual rates of termination with respect to aggregate experience and selected CBS experience are ascertainable by calculating for each of the pertinent periods (a) the total number of years commenced by all of the affiliation contracts in the respective experience during the period in question, (b) the total number of terminations occurring during such period, and (c) an annual rate of termination derived by dividing (a) into (b). The rates of termination separately calculated for each of these two segments of experience through the end of 1957, the end of 1958, and the end of 1959 ranged from .040 to .068 as shown in the following table:

Annual Rates of Termination for Aggregate Experience and Selected CBS Experience Based on Information Available at End of 1957, 1958, 1959, 1962

Year through which experience is determined	Aggregate experience			Selected CBS experience		
	Number of affiliation years commenced	Number of terminations	Rate of terminations	Number of affiliation years commenced	Number of terminations	Rate of terminations
1957	944	64	.068	143	6	.042
1958	1,110	70	.063	203	10	.049
1959	1,274	77	.060	272	11	.040
xxx	xxx	xxx	xxx	xxx	xxx	xxx
1962	1,767	88	.050	503	19	.038

Taking into consideration the several rates of termination calculated through the years 1957, 1958, and 1959, the rate of .050 (or 5 percent) is the single figure representing an annual rate of termination that best reflects both segments of experience with respect to the taxable years here in issue.

Using this rate of termination, a table[2] of life expectancy applying the Poisson-exponential theory was con-

2. This was prepared from data relating to both the "aggregate experience" and the "selected CBS experience."

structed by petitioner's expert statisticians. Based on this life expectancy table, two types of average life can be determined—a "median" life and a "mean" life. The median life of network affiliation contracts is between 13 and 14 years; that is, the probability is that more than half of the contracts out of a large group of affiliations will not survive 14 years. Further, on the basis of the life expectancy table, the mean life of an affiliation in a large group of contracts is 20 years; that is, the sum of the ages at which all contracts in the group would terminate, divided by the number of contracts in the group, would be 20 years. In this connection the life expectancy table shows that 64.15 percent of the group of contracts will terminate by the end of the 20th year.

The statistical methods thus employed are customarily used and relied upon for many purposes, including the determination of prices, costs, charges, terms of warranties, and requirements for maintenance, and the design and cost of complex apparatus used in our defense program.

In his notice of deficiency dated September 27, 1961, the respondent gave the following explanation of the adjustments made to the depreciation deductions claimed in petitioner's Federal income tax returns for the years in issue:

> It is determined that deductions claimed on your Federal income tax returns for the taxable years ended November 30, 1957, November 30, 1958, and November 30, 1959, for amortization of television network affiliation contracts in the respective amounts of $2,910,714.32, $972,063.49, and $493,809.60 are not allowable deductions under the provisions of section 167 of the Internal Revenue Code of 1954 or under

the provisions of any other section of the Internal Revenue Code of 1954.

Ultimate Findings

1. The basis to petitioner of the two network affiliation contracts with CBS was at least $4,625,000, and this basis was properly allocated $4,000,000 to the WISH-TV contract and $625,000 to the WANE-TV contract.

2. The two CBS network affiliation contracts with WISH-TV and WANE-TV do not constitute goodwill.

3. From the statistical data and analyses based upon the general experience of the television industry, the estimated useful life of the two CBS network affiliation contracts with WISH-TV and WANE-TV is ascertainable with reasonable accuracy.

4. Use of a 20-year straight-line method produces a reasonable allowance for depreciation.

Opinion

Is the petitioner entitled to deductions for depreciation or amortization of CBS television network affiliation contracts it acquired by the purchase of television broadcasting stations WISH-TV and WANE-TV? That is the principal question presented in this case. The parties agree that its resolution involves the three subsidiary questions of (1) the proper allocation of basis to the contracts in accordance with their value, (2) whether such contracts constitute goodwill and (3) whether the useful lives of such contracts can be estimated with reasonable accuracy, as required by section 167(a), Internal Revenue Code of 1954, and the regulations promulgated thereunder.[3] We are

3. SEC. 167. DEPRECIATION

(a) General Rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

Sec. 1.167(a)-1 [Income Tax Regs.] Depreciation in general.

(a) Reasonable allowance. Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence

satisfied, as set forth in our Findings of Fact, that the proof adduced by petitioner establishes the basis to it of the two network affiliation contracts with CBS at $4,625,000 and that this basis was properly and reasonably allocated $4,000,000 to the WISH-TV contract and $625,000 to the WANE-TV contract[4] Petitioner's evidence, based upon the testimony of a broker experienced in the purchase and sale of tele-

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of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(f) and § 1.167(f)-1. * * *

(b) Useful life. For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. * * * If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination.

Sec. 1.167(a)-3 [Income Tax Regs.] Intangibles.

If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to goodwill.

4. Actually the allocation between the two contracts is of little practical consequence in computing deductions for depreciation because the termination dates of the two contracts were substantially identical.

vision stations and proof of comparative income of WISH-TV and its competitors, was not challenged in any respect by respondent's witnesses and stands uncontradicted.

Respondent contends, in the alternative, that the CBS network affiliation contracts of WISH-TV and WANE-TV represent the going concern value of petitioner's business or its customer structure, viz., goodwill, which is not subject to an allowance for depreciation under section 1.167 (a)-3, Income Tax Regulations. These contracts, respondent argues, gave the two stations assurance of advertisers as customers and, therefore, either directly or indirectly, provided the stations with the opportunity of securing substantial revenue. Petitioner counters with the assertion that the network affiliation contracts do not constitute goodwill. We agree with the petitioner.

The value of a CBS affiliation contract lies in obtaining programs with high audience appeal which is necessary for securing advertising revenues.[5] The principal value and function of the CBS contracts to petitioner consisted of the supply of attractive programs which it assured. Attractive programs bring advertisers and advertisers produce income.

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5. The importance to a television station of a CBS network affiliation contract stems directly from the basic economics of commercial television broadcasting. A television station has nothing to sell its advertisers except the ability to reach an audience. This ability derives, in turn, from the attractiveness to the public of the programs the station broadcasts. A station must either produce programing itself or obtain it from other sources. Up to now, the television networks have been the most valuable sources of programing with high audience appeal. Of the networks, CBS has over the years consistently been able to supply programing with high audience appeal. The affiliation contracts here involved assure the petitioner of this highly-prized CBS network programing. Moreover, this programing is supplied under the affiliation contract without any cash outlay. Thus the contract not only increases the station's revenue by increasing its audience but also decreases its operating expenses by reducing the need to purchase programs.

The fallacy of respondent's position is in the legal conclusion which he draws from the facts. The acquisition of an asset or service that will attract customers is not goodwill. An efficient plant or machine will bring customers, as will an attractive sign or handsome decor, but their cost is not considered a part of goodwill. Nor does a contract to acquire such assets or services constitute goodwill. Cf. *Pittsburgh Athletic Co.*, 27 B.T.A. 1074 (1933), affd. 72 F. 2d 883 (C.C.A. 3, 1934), involving baseball player contracts which were held not to be goodwill. We do not see how the acquisition of the means of attracting customers can be goodwill.[6]

The evidence demonstrates that by far the largest portion of petitioner's revenue came from sources other than the network. Approximately 74 percent came from non-network programs and announcements derived entirely from sales made by WISH-TV itself through the efforts of its own advertising salesmen or its national sales representative. Therefore, it is clear that the network contract does not provide the bulk of the station's revenues but provides only, by its supply of attractive programs and the audiences they draw, a substantial advantage in the competition for advertising dollars.

Even with respect to the 26 percent of its total revenue which flowed to WISH-TV from network programs, the

6. This distinction was pointed out by petitioner's witness Tower, who has had considerable experience with the problems of television stations and management. On cross-examination he was asked whether stations wished to have affiliation contracts with CBS because they felt there would be a great possibility that the stations would acquire advertisers as customers. In reply Tower stated:

"Well, I think there is a missing step there, Mr. Becker. They do it to get large audiences because the CBS network has, as in the past and now does, provide the most popular programming—the best programming in terms of audience appeal. If you have that programming, of that audience appeal, in a market like Indianapolis, you get the greater advertiser interest."

affiliation contract did not constitute goodwill. This revenue was derived by petitioner from a single affiliation contract with the network itself and not from a collection of individual contracts between petitioner and the advertisers. The station's continued receipt of this revenue can be terminated by a decision of the network not to renew the affiliation contract. This single contract is totally unlike the case of a mass of contracts with a number of customers, which are in a constant state of flux as some let their contracts expire and other persons are continually solicited as additional customers. See and compare *Thrifticheck Service Corporation,* 33 T. C. 1038 (1960), affd. 287 F. 2d 1 (C. A. 2, 1961); *U. S. Industrial Alcohol Co.,* 42 B. T. A. 1323 (1940), affirmed on this issue 137 F. 2d 511 (C. A. 2, 1943); and *Richard M. Boe,* 35 T. C. 720 (1961), affd. 307 F. 2d 339 (C. A. 9, 1962).

It is significant that WISH-TV and WANE-TV began broadcasting in 1954, little more than 2 years before their acquisition by petitioner, and that other television stations had preceded them in their communities. WISH-TV and WANE-TV were not old established businesses of the type normally deemed to have acquired goodwill. We think the sum of $1,974,325.33, allocated to goodwill and other intangible property, including FCC licenses, was sufficient to provide a substantial amount for whatever amount of goodwill, as such, these two stations had built up in their two years of operation.

Lastly, we turn to a consideration of the important and pivotal question of whether it is possible on this record to estimate the useful life of these network affiliation contracts with reasonable accuracy and, if so, what that useful life is.

Petitioner asserts that the capital cost of the contract is properly recoverable through annual deductions over a period of 14 years either (a) because the estimated useful life of the contracts including renewal periods, for deprecia-

tion purposes, is 14 years or (b) because no more than six 2-year renewals can be reasonably anticipated. Petitioner also asserts that from the statistical data and analyses in evidence, the estimated useful life of the contracts, within the meaning of section 167(a) and the regulations governing depreciation, can be determined with the degree of accuracy required for depreciation purposes; and that use of a straight-line method of depreciation over a period of 14 years (or original term plus six renewals) produces a reasonable allowance for depreciation. Respondent argues to the contrary that, regardless of the statistical data and calculations based upon industry experience, no deduction for depreciation or amortization should be allowed because the life of television network affiliation contracts is not limited but is indefinite and indeterminate.

We must necessarily approach this problem against the backdrop of our prior opinion in *Westinghouse Broadcasting Company, Inc.*, 36 T.C. 912 (1961), affd. 309 F. 2d 279 (C.A. 3, 1962), certiorari denied 372 U.S. 935 (1963), the only other case involving depreciation of network affiliation contracts.[7] There the network affiliation contract had 7 months to run on an existing term at the time of its acquisition by the taxpayer, but was renewed during the initial taxable year for an additional term of 24 months.

7. The matter of depreciation of the cost of intangible assets having a fixed initial term with possibilities of renewals for further terms has been before the courts in many cases involving contracts, leases, franchises, and similar property. The issue has been whether depreciation should be taken over the period of the initial term without regard to possible renewals, as has been held in some cases, or whether possible renewal terms should be taken into account, as held in other cases; and, if renewal terms are to be taken into account, how many such possible additional terms should be included. See *Jos. N. Neel Co.*, 22 T.C. 1083 (1954); *Cleveland Railway Co.*, 36 B.T.A. 208 (1937), which permitted depreciation or amortization of costs relating to renewal agreements.

The taxpayer contended, among other things, that the cost should be amortized over this 31-month period without taking into account possibilities of further renewals by the parties to the contract.

At the beginning of our opinion the effect of the renewal provision in the affiliation contract was analyzed and the two extreme positions of the parties set forth. One of the extremes would allow depreciation over the 2-year term; the other would automatically deny all depreciation (36 T.C. at 918-919). In addition to these two extremes, there was available the middle ground, based on several decisions involving renewal clauses in leases and other contracts, that depreciation should be calculated by reference to the initial contract term plus "all its probable renewals." We adopted this middle ground by declaring that "there remains to be determined the probable useful life of the contract with all its probable renewals"; that "the probability of renewals is a question of fact"; that "petitioner must show more than uncertainty as to the length of the contract's useful life"; that "for the purposes of depreciation, determination as to probable useful life must be based upon facts known or estimates made at the time a return is filed" [citing cases]; and that while the practice in the trade in valuing network affiliation contracts was to assume two renewals, we did not consider "that an industry practice as to valuation of a contract is a sufficient indication of that contract's probable useful life." Consequently, we concluded (36 T.C. at 922):

> Insufficient evidence was introduced from which could be calculated either the average useful life of network affiliation contracts or their usual life span.

In affirming our decision the Court of Appeals for the Third Circuit, after noting that the burden of proof was on the taxpayer, stated (309 F. 2d 282-283):

> Taxpayer did not adduce any testimony to the effect that based on "experience" in the television industry the number of renewals of the network affiliation contract could be "estimated" with "reasonable certainty" or "reasonable accuracy" as required by the Treasury Regulations earlier cited.
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>
> Nor can any probative value with respect to the "probable useful life" of the network affiliation contract here be attributed to the stipulated fact that "between January 1, 1953 and April 1, 1960, a total of 87 NBC affiliation agreements expired in circumstances other than a station going off the air or the acquisition of the affiliate by the network" *since there was no evidence as to the actual life span of those agreements or as to the number of their renewals.* [Emphasis supplied.]

The trial of the instant case was devoted primarily to supplying the essential evidence upon which to determine the probability of future renewals. Since petitioner's own experience during the pertinent taxable years did not provide an adequate basis for making this determination, the inquiry, directed in the *Westinghouse* case, as to the usual life span of network affiliation contracts must, according to respondent's regulations, be determined by reference to the "general experience of the industry." This provision is an obvious necessity for new corporations, such as the petitioner, and for others acquiring assets of a type not owned previously. It is essential to a practical administration of the revenue laws. Indeed, we fail to see how the revenue would suffer from the use by a group of taxpayers of a rate derived from general industry experience.

Depreciation, by its very nature, is an estimate of future events distilled from the prologue of history. Preci-

sion is not required. *Massey Motors, Inc.*, v. *United States*, 364 U. S. 92 (1960). Analysis of historical evidence traditionally serves as the means for forecasting probabilities of future life. It is commonplace in the tax law to use forecasts of duration of life made in this manner.[8]

Selection of the past experience upon which to base a life expectancy table in the instant case was made by petitioner's witness Tower. In making this judgment as to the selection of experience, Tower had before him Exhibit 19-S, a compilation of the history of network affiliation contracts from the beginning of the television industry to substantially the date of trial. This compilation covered all of the 84 market areas in the United States in which there were three or more television stations in operation on December 31, 1962. It was the joint product of the efforts of petitioner and respondent; and the information thus developed was integrated and, at respondent's request, the result was verified by the CBS and NBC television networks. In the case of each affiliation contract mentioned in the compilation, its date of commencement and, if terminated, its date of termination, was established and stipulated.

From this totality of information, Tower selected those segments of the industry experience which, in his judgment, were germane to the issue, namely, the determination of the estimated useful life of the petitioner's network affilia-

8. Life expectancy tables for human beings, constructed on the basis of prior mortality experience, are used to determine the period over which a person purchasing a life estate in property may depreciate his cost for income tax purposes. See *William N. Fry, Jr.*, 31 T.C. 522 (1958), affirmed per curiam 283 F. 2d 869 (C.A. 6, 1960); and *Bell* v. *Harrison*, 212 F. 2d 253 (C.A. 7, 1954). Similarly, statistical tables, derived from past experience, as to the probability of voluntary change in a human relationship, such as remarriage, are used in determining tax liabilities. See Estate of *Pompeo M. Maresi*, 6 T.C. 582 (1946), affd. 156 F. 2d 929 (C.A. 2, 1946); and *Estate of Jean S. Alexander*, 25 T.C. 600 (1955).

tion contracts for depreciation purposes. Tower testified that he thought two types of experience should be taken into account—one of a broad nature designated "aggregate experience" and a second, narrower type, designated "selected CBS experience."

The "aggregate experience" represented the experience with respect to all of the CBS and NBC network affiliation contracts from 1948 through 1962. These contracts contained comparable provisions to the ones before us. Eliminated from this experience were the ABC contracts, which had a higher incidence of termination, and the few stations owned and operated by CBS and NBC, which were not subject to the risk of termination because of the contractual relationship between the network and the station. The "aggregate experience" included the period of the FCC "freeze" on new stations, in which there were relatively few terminations, and a subsequent period (1953-1955) in which there were relatively more terminations as an increased number of new stations came on the air. As Tower explained, over the years of commercial television history there have been "ebbs and flows in the incidence of termination of network contracts."

"Selected CBS experience" took into account experience regarding CBS affiliations only "for periods after which there was at least one other station in the market for 12 months or more that was neither affiliated with NBC nor owned and operated by ABC." This experience was analyzed because it is comparable to the present case in being limited to CBS contracts after there were sufficient stations in the particular market to give CBS the opportunity to choose between its existing affiliate and at least one other station in the community not affiliated with NBC. In order to prevent this experience from being affected by terminations directly occasioned by the third station in the community coming on the air, experience prior to the end

of a minimum 12-month stabilizing period following that event was eliminated from consideration.

Then, petitioner's expert statisticians were asked to analyze the "aggregate experience" and "selected CBS experience" as described by Tower. As a part of their analysis, they derived an annual rate of termination of the contracts for each of the two types of experience through the end of the year 1957. They also made similar determinations for each type of experience through the end of 1958, the end of 1959, and the end of 1962. The annual rates of termination separately so computed showed some variations according to the type of experience and the length of period considered. These separately determined annual rates of termination were then presented to Tower and he was asked his judgment, based on the six rates through 1957, 1958, and 1959 (ranging from .040 to .068), as to an appropriate single annual rate of termination that might be used by the statisticians in constructing a life expectancy table applicable to these network affiliation contracts.

Tower testified that, taking all factors into consideration, he would use for preparation of a life expectancy table and calculation of average life an annual rate of termination of .050 or 5 percent. In addition to the factors contained in our Findings of Fact, Tower said he also took into account: (1) the long-established policy of Congress and the FCC to encourage the use of UHF to bring on the air a greater number of commercial television stations; (2) the serious consideration given by the FCC to moving television broadcasting "upstairs" whereby all stations would be transmitting on the UHF band; (3) the advent of pay television; and (4) possible technological advances, such as Telstar.

Petitioner's statisticians analyzed the information contained in "aggregate experience" and "selected CBS ex-

perience" and found that the statistical data was consistent with the Poisson-exponential theory of failure, a statistical method which has been widely used to calculate tables of life expectancy and average life of various items. Based upon the .050 annual rate of termination and applying the statistical methods explained in their report and testimony, the statisticians developed the life expectancy table for network affiliation contracts. This table shows that the *median* life of the contracts is just under 14 years and that the *mean* life of the contracts is approximately 20 years. The mean life gives effect to the fact that under the life expectancy table a small proportion of the contracts may be expected to have lives that are relatively long in comparison with those of the bulk of the contracts. The calculations with respect to the mean life show that there are about two chances out of three that a contract will terminate before it completes its 20th year.

The answer to respondent's contention that the contracts in question cannot be depreciated or amortized because their life is "indefinite" or "indeterminable" is that almost every asset subject to depreciation has an indefinite or indeterminable life in the sense that no one can foretell the exact date of its coming to an end.[9] The life of a particular asset, whether it be an automobile, a telephone pole, or a race horse, cannot be foretold because human beings are not gifted with such clairvoyance. All that can be said is that there are certain probabilities of survival

9. A network affiliation contract is unlike distributorships and other arrangements of "indefinite" length where a franchise holder may have rights to resist termination, either by specific terms of contract or by general rules of law. See *Coca-Cola Bottling Co.*, 6 B.T.A. 1333 (1927), where the contract could not be cancelled so long as the taxpayer "vigorously and properly" pushed the sale of bottled Coca-Cola; and *Allied Equipment Co.* v. *Weber Engineered Products, Inc.*, 237 F. 2d 879 (C.A. 4, 1956), involving a distributorship under an at-will contract.

and that "average" lives can be determined. To be sure, the respondent's own regulations recognize this lack of human clairvoyance by referring to "estimated useful life" throughout the depreciation provisions, and, in dealing specifically with intangibles, the regulations refer to the length of life which "can be estimated with reasonable accuracy." Consequently, we think it is irrelevant that some network contracts in a group of such contracts may be expected to have an unusually long life as compared with the average life of the group. The statistical analysis presented by petitioner's expert witnesses takes such probability into account and, in determining average life, gives it the proper mathematical weighting. The fact that experience, opinions, or statistical projections may indicate that a few units may attain an exceptional or unusual age is disregarded in depreciation practice, except to the extent that such long-lived assets influence calculation of average life.

At the trial and on brief the respondent criticized Tower's selection of an annual rate of termination of .050 (5 percent) on two grounds. First, respondent argues that the rate used in determining the probability of termination of petitioner's affiliation contracts is distorted by a heavy concentration of terminations in the years 1953-1955 (period of adjustment) and should be lower than the rate of termination reflected in the segments of industry experience selected by Tower. Second, as a general matter, respondent asserts that a more restricted sub-grouping of industry experience was required to prepare an applicable life expectancy table. We think these assertions are refuted by the record and are contrary to the well-established practices for determining life expectancy in tax matters. Perhaps the most we can say about respondent's evidence is that it presents a modest challenge to the rate of termination used. Of course, any selection of prior

experience on which to base an estimate of future life can be subjected to some criticism. But the controlling considerations relevant here are that petitioner's contracts are of the same type as the contracts whose history of termination is reflected in Exhibit 19-S, and that petitioner's contracts are subject to many and varied competitive economic forces such as gave rise to the prior terminations of such contracts.

Likewise, we are not persuaded by respondent's contention that the standard error used by petitioner in preparing the life expectancy table is unreliable because the "underlying conditions and circumstances in the television industry do not constitute a *stable force* extending into the future." This general contention, without more, carries little weight, especially since the same thing can be said about any youthful industry in these times of rapidly changing scientific technology. As we have previously pointed out, depreciation requires only an estimate, not exactness. It seems to us that the petitioner has offered sufficient evidence, based *on general industry experience* over 15 years, to establish the "average" lives of these network affiliation contracts with *reasonable accuracy.*

Respondent's attack on the petitioner's position stresses the "lack of comparable data" upon which petitioner's estimates were based. This assertion totally disregards the testimony of Tower, who gave his opinion as to the industry experience "reasonably comparable to the situation as it existed in Indianapolis for WISH-TV during the years" in issue.

On brief the respondent makes a station by station examination of industry data attempting to show that individual stations experiencing terminations included in the industry experience selected by Tower are in certain details

dissimilar to petitioner's television stations.[10] We think this approach is wholly inconsistent with the respondent's regulation which permits a determination of useful life to be made by reference to "general experience in the industry."[11] What respondent has done in his brief is to ferret out factors reflected in general experience which he argues would tend to project an unduly long life expectancy as applied to petitioner, and to ignore all countervailing factors. Naturally, some instances included in any general experience will contain factors tending to a longer life expectancy than might be appropriate to a particular taxpayer, while other instances included in the general experience will contain factors tending to a shorter expectancy.

10. Respondent set forth a series of individual objections asserting lack of comparability of 23 specific terminations with petitioner's situation because of various circumstances, many of them speculative. In addition, respondent has attempted to dismiss entirely segments of experience including 56 terminations assertedly occurring prior to the arrival of a third station in the particular market area. But the data shows that 15 of these 56 terminations occurred at times unrelated to the arrival of any station in the market; 17 represent cases in which CBS and NBC were not affiliated with the same station at the time of the termination; and 5 represent cases in which the network did not make the termination when the second station came on the air but continued the dual affiliation with the first station until the third station arrived.

11. It is noteworthy that while respondent disagrees with the conclusions which petitioner's expert witnesses drew from prior experience of other television affiliation contracts, he does not contend that such experience is irrelevant to the matter at hand. Indeed, the start of the present controversy, Rev. Rul. 57-377, 1957-2 C.B. 146, described in some detail respondent's interpretation of industry experience regarding affiliation contracts. In that ruling respondent found the existence of sufficient similarity in television affiliation agreements to permit promulgation of a ruling which was by its terms applicable to affiliation contracts throughout the industry. The opinions of both this Court and the Court of Appeals in *Westinghouse* also reflect the premise that conclusions applicable to a specific contract can be drawn from experience as to other contracts in the hands of other owners.

The theory behind the regulation is that these factors will tend to balance off, and that the statistically derived life expectancy, uniformly applied, will produce a result proper both for the taxpayers and the Government. It is inconceivable that a petitioner before this Court, endeavoring in good faith to develop a rate of depreciation based on "general experience in the industry," can be required at its peril to prove that all cases included in its statistics are in every respect identical to the petitioner's circumstances, or else forfeit all depreciation. This rule permitting use of general industry experience is both logical and practical: *logical* because the national treasury cannot suffer from the use of a general average by a group of taxpayers; and *practical* because it alleviates the burden which would be placed on the courts to hear testimony of numerous witnesses regarding the detailed facts of other cases in the industry to determine case by case the degree of their similarity to the taxpayer's situation. In the light of the evidence adduced by petitioner, we are convinced that none of respondent's criticisms warrant our holding that petitioner's case is so different from that of the general experience of the industry that the useful life or probable number of renewals of its contracts cannot be determined with the degree of accuracy required to permit a "reasonable allowance" for depreciation. Accordingly, we hold that the petitioner is entitled to depreciation deductions on its CBS network affiliation contracts on a 20-year straight-line method. Cf. *WDEF Broadcasting Company* v. *United States,* 215 F. Supp. 818 (D.C.E.D. Tenn., 1963); and *Birmingham News Co.,* v. *Patterson, Jr.,* 224 F. Supp. 670 (D.C.N.D. Ala., 1963).

Reviewed by the Court.

Decision will be entered under Rule 50.

APPENDIX E

Analysis Made in Testimony of Dr. Ralph C. Jones of the Effect of Depreciation of Network Affiliation Contracts on Taxpayers and the National Treasury

At the trial, Dr. Ralph C. Jones offered testimony accompanied by charts which demonstrated that straight-line depreciation of network affiliation contracts over a 20-year period would result in fairness to taxpayers and a proper flow of revenue to the national Treasury (R. 178-198; Ex. 26, 27).* This testimony was based on the life expectancy table developed by Drs. Deming and Glasser and reflected provisions in the Treasury Regulations bearing on losses occurring on termination of contracts whose cost had not been fully recovered by annual depreciation deductions. In this Appendix, the analysis made by Dr. Jones is described, together with the taxpayer's presentation of some points briefly made in his testimony, in substantially the form presented in the taxpayer's briefs in both courts below.

Dr. Jones first pointed out that there are three possible accounting methods of allocating the cost of an asset as between various taxable years (R. 178-179):

(1) At one extreme, there would be an immediate write-off of the entire cost of the asset in the year of acquisition.

(2) At the other extreme, there would be a terminal write-off of the entire cost of the asset at the end of its useful life.

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* Dr. Jones is Professor of Economics at Yale University, where for almost 40 years he has been in charge of all courses in accounting. He has made various scholarly studies of economic matters relating to accounting and taxation (R. 177-178).

Nine copies of Ex. 26 and 27 have been furnished for use of the Court.

(3) As a middle ground, there would be a spreading of the cost of the asset over its period of useful life by depreciation or amortization deductions.

Dr. Jones rejected the two extremes, stating, in terms of network affiliation contracts, that "to report income fairly the cost would have to be spread over the period of useful life of the affiliation" (R. 179). The balance of his testimony was devoted to explaining the construction and use of a "benchmark" for the purpose of testing proposed methods of accounting for asset cost over a period of useful life with respect to the fairness of such methods to taxpayers and the Treasury.

Principles of Depreciation Illustrated. Before testifying as to the specific life expectancy table developed by Drs. Deming and Glasser, Dr. Jones first explained the theory involved in constructing a "benchmark" by reference to a simple hypothetical illustration. He assumed that nine different taxpayers each own a "unit" of the same type, that the nine units will have lives varying from one year to nine years, and that it is possible from the beginning to foretell with precision the future life span of each particular unit. He explained that obviously in such case the taxpayer whose unit it is known will last one year should deduct the entire cost in the first year; that the taxpayer whose unit it is known will last two years should depreciate the cost over two years, and so on.

There was then introduced into evidence a chart prepared by Dr. Jones showing that, assuming each unit cost $1,000 (a total of $9,000 for the nine units), the cumulative aggregate depreciation to be taken by the nine taxpayers

by the end of each of the nine years would be as follows (Ex. 26, Chart I):

Year	*Aggregate Depreciation Taken by the 9 Taxpayers (Cumulative)*	*Percentage of Total*
1	$2,829	31.4%
2	4,658	51.8
3	5,987	66.5
4	6,983	77.6
5	7,729	85.9
6	8,274	91.9
7	8,652	96.1
8	8,888	98.8
9	9,000	100.0%

There was also introduced in evidence a chart prepared by Dr. Jones showing a curve reflecting the cumulative aggregate depreciation year by year as noted above (Ex. 26, Chart II), referred to in the testimony as a "benchmark curve" (R. 185-186, 188-189).

Dr. Jones then discussed the method of depreciation accounting to be employed in the hypothetical case if instead of each taxpayer having foreknowledge of the precise future life span of his particular unit, it were assumed that no taxpayer could foretell with certainty how long his particular unit would last, but it could be predicted that the group of units would follow the same pattern of lives, i.e., that one unit would last one year, another unit two years and so on, as before. This, of course, is the situation that exists with respect to most depreciable property, where prior experience permits a prediction as to the average future life of a group of items but does not permit foreknowledge of the life of a particular item in the group.

Testimony of Dr. Jones

Dr. Jones testified that in such a case, since none of the taxpayers could foretell the life of his particular unit, "each taxpayer would have to use some kind of an average rate" (R. 186) to compute depreciation. Dr. Jones pointed out that on the facts assumed the average life would be five years (*ibid.*).

Accounting for Early Retirements. Assuming each taxpayer in the hypothetical illustration used five-year straight-line depreciation, Dr. Jones then dealt with the accounting treatment of units which are retired at some point during the first five years. On the assumed facts this would occur in the case of four of the nine taxpayers. He noted that such taxpayers under normal accounting practices would take loss deductions at the time of retirement in the amount of the then remaining undepreciated cost of their units (R. 187).

The aggregate deductions allowed to the nine taxpayers would consist of (a) depreciation deductions for all the taxpayers plus (b) loss deductions for those taxpayers whose units are retired before average life is reached. Thus at some point in time before the five-year average life is reached, the cumulative aggregate deductions for the nine taxpayers as a group would, in absence of some adjustment, exceed the cumulative aggregate deductions for the nine taxpayers reflected on the benchmark curve. This result, Dr. Jones testified, would tend to accelerate aggregate deductions for depreciation and retirement losses to the disadvantage of the Treasury, as compared with the benchmark curve (R. 186-188).

Treasury Regulations on Accounting for Depreciation and Early Retirement. It is evident that the owner of each individual unit is entitled to some reasonable allowance for depreciation each year. Yet to deal in an evenhanded manner with the Treasury, the aggregate depreciation and retirement loss deductions for the group should correspond in a reasonable manner with the benchmark so that the

timing of the deductions for the group in the aggregate is not unjustifiably accelerated.

Treasury Regulations Section 1.167(a)-8 is directly applicable in providing rules relating to deduction for retirement losses where taxpayers using item accounts depreciate on the basis of an estimated average useful life (i.e., five years in the hypothetical illustration). An "average" life necessarily takes into account both those items which will be retired before reaching average life and those which will survive beyond average life. In prescribing rules relating to early retirement where a taxpayer calculates depreciation on the basis of average life, the Regulation requires that where deductions of loss on early retirement would "substantially distort income" (par. (d) (3)), the remaining undepreciated cost at the time of retirement must be amortized over a future period equal to the average life previously used for depreciation purposes. The effect of this amortization requirement is to assure that the combination of depreciation and loss deductions will not substantially understate taxable income. Thus the Regulation recognizes and deals with the fact that use of average life for computing depreciation will inevitably accelerate deductions if loss deductions are allowed for retirements in advance of attaining the average age, and provides appropriate protection for the Treasury to prevent distortion of income.*

Depreciation Accounting for Network Affiliation Contracts. Following Dr. Jones' discussion of the hypothetical case, there was then introduced in evidence a series of

* On the basis of this Regulation, proper tax accounting in the hypothetical illustration permits use by each individual taxpayer of an average life of five years in determining straight-line depreciation, but with loss deductions to be amortized over the five-year period following an early retirement if immediate allowance of the full loss from early retirement would on the particular facts substantially distort income.

charts prepared by Dr. Jones based upon the life expectancy table for network affiliation contracts developed by Drs. Deming and Glasser (Ex. 27, Charts A-G). Chart A contained a "benchmark" curve reflecting for a period of 25 years the mathematically derived and theoretically proper cumulative aggregate allowances for depreciation for a group of taxpayers, each owning an affiliation contract acquired at the same time and at the same cost, where the lives of the contracts conform to the life expectancy table.

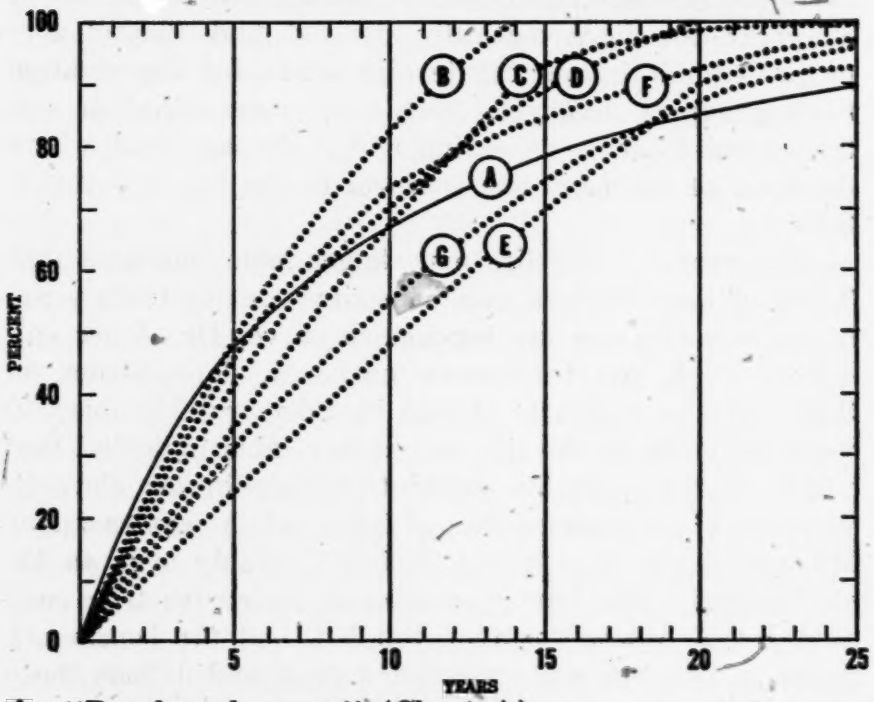
For example, the life expectancy table indicates that 3.15% of the contracts would terminate in the tenth year; hence in preparing his benchmark curve, Dr. Jones calculated that, for benchmark purposes, depreciation on 3.15% of the contracts should be taken ratably over 10 years. Similarly, the life expectancy table indicated that 2.99% of the contracts would terminate in the eleventh year; and thus depreciation on 2.99% of the contracts for benchmark purposes would be taken ratably over an 11-year period. The depreciation on all the contracts in each year for 25 years was then totalled, and the benchmark curve in Chart A was constructed from and reflects these totals for each year (see R. 189-190).

The benchmark curve prepared by Dr. Jones from the life expectancy table of Drs. Deming and Glasser reflected, just as did his benchmark curve in the hypothetical case, the cumulative aggregate depreciation that would be allowable for all taxpayers in the group at the end of any year if it were possible for each taxpayer in the group to foretell the future life span of his particular contract. Such a benchmark curve would show the aggregate effect for the Treasury of depreciation deductions taken on a theoretically perfect basis by all taxpayers for a group of contracts whose lives conform to the life expectancy table. Thus here, as in the hypothetical case, the benchmark curve

Appendix E

COMPOSITE CHART OF EXHIBIT 27

(Comparison of cumulative aggregate depreciation and loss deductions under six accounting methods)



A "Benchmark curve" (Chart A)

B 14-year straight-line depreciation with loss allowed on termination (Chart B)

C 14-year straight-line depreciation with loss on termination amortized (Chart C)

D 20-year straight-line depreciation with loss allowed on termination (Chart D)

E 20-year straight-line depreciation with loss on termination amortized (Chart E)

F 14-year multiple straight-line depreciation with loss allowed on termination (Chart F)

G 14-year multiple straight-line depreciation with loss on termination amortized (Chart G)

Source: Ex. 27, Charts A-G. [The composite chart and captions on this page were set forth in the taxpayer's briefs in both courts below.]

serves as a measure against which to test from the Treasury's standpoint the general reasonableness of the method of depreciation to be adopted by each individual taxpayer (see R. 189-190).

There were then introduced as a part of Exhibit 27 six additional charts (B through G) prepared by Dr. Jones to show the effect of six different methods of accounting for depreciation and retirement loss deductions for affiliation contracts whose lives conform to the life expectancy table. On each of these charts there appears a solid line representing the benchmark curve and a dotted line representing the cumulative aggregate of (a) deductions for depreciation on all the contracts and (b) loss deductions for the remaining undepreciated cost of any contracts terminating before being fully depreciated. In the composite chart appearing on the opposite page (which was also set forth in the taxpayer's briefs in both courts below), the benchmark curve and the dotted lines appearing on each of the six charts have been reproduced for ease of reference.

Charts D and E show the results of straight-line depreciation based on the 20-year life ultimately determined by the Tax Court, in one case with losses allowed on termination (Chart D), and in the other case with losses on termination amortized (Chart E). Charts B, C, F and G show the results of other rates and methods of depreciation which were rejected by the trial court.*

* Charts B and C show the cumulative deductions which would be allowed to taxpayers if a 14-year straight-line method were adopted, the result for which the taxpayer contended on trial. (The life expectancy table shows 14 years to be the point of time at which the probability of a contract's survival becomes less than 50% (R. 166); see discussion in this petition for certiorari, pp. 16-18, *supra*.) The Tax Court rejected the taxpayer's contention in this regard, and determined that depreciation was to be computed on a 20-year straight-line method. As Dr. Jones stated, "there is no one answer" in the selection of a rate of depreciation (R. 195), and the taxpayer, acknowledging that the rate of depreciation is a question of fact, did

Appendix E

Chart D shows that under 20-year straight-line depreciation with losses on termination allowed, taxpayers as a group would be claiming lower deductions (aggregate depreciation allowances and retirement losses) for the first seven years than would be indicated by the mathematically derived benchmark, and thereafter the actual deductions claimed by taxpayers would exceed the amount indicated by the benchmark curve. Chart E shows that if losses on termination are amortized, the actual deductions claimed by taxpayers would be less than the benchmark for about 18 years and thereafter rise above it (R. 192-194).

Although the trial court was not faced with the issue whether losses on termination should be amortized or deducted, and therefore did not decide this question, the charts and testimony of Dr. Jones show that in either case a 20-year straight-line method produces a depreciation allowance which is fair both to taxpayers and the national Treasury.

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not seek to disturb on appeal the Tax Court's rejection of its 14-year contention.

Charts F and G show the results of a method of depreciation described by Dr. Jones as "multiple straight-line" on the basis of a 14-year life. Under this method, during each year of the first two-year term of the contract, depreciation would be allowed on the basis of 1/14 of the cost; in the event of its renewal for a two-year term, depreciation during each year of the first renewal term would be determined at 1/14 of the remaining undepreciated cost as of the start of that term; and upon each succeeding renewal, depreciation during each year of such renewal term would be calculated at 1/14 of the remaining undepreciated cost at the start of that renewal term (R. 181-183). It is akin to a declining-balance method of depreciation.